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NO. 20764

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

ALHAMBRA MOTOR PARTS, et al.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

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PETITIONERS' OPENING BRIEF

ON

PETITION TO

REVIEW ORDER OF

FEDERAL TRADE COMMISSION

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Attorney for Petitioners





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INTRODUCTION

This is a petition to review a decision and order of the Federal Trade Commission.

The complaint (3-27) 1/ filed in 1957, charged Southern California Jobbers, Inc. (referred to as SCJ) with being the medium or instrumentality whereby the other respondents (who are jobbers of automotive parts) induced discriminating prices and discounts from their suppliers (22-23).

The answer (28-34) denied the essential allegations of the complaint and set up a defense of cost justification.

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1/ Figures in parentheses refer to pages of the Transcript unless otherwise designated.





Thereafter, on June 20, 1960, the Trial Examiner rendered his initial decision (35-64) and recommended a cease and desist order. This was adopted as the order of the Federal Trade Commission (65-66).

A petition for review was filed by respondents and this Court, after argument, rendered its opinion on October 9, 1962.

Alhambra Motor Parts, et al. v. Federal Trade  
Commission, 309 F.2d 213 (C.A. 9).

This decision affirmed that part of the order applying to the brokerage operation because the petitioners conceded the point. As to the warehouse operation, the order was set aside and remanded for further consideration of the cost justification defense and "the status of SCJ as the buyer and direct recipient of the price differential. "

Subsequently, on May 18-24, 1964, a new hearing was held before a Trial Examiner who rendered his "Supplemental Initial Decision on Remand of a Proceeding" on November 20, 1964 in which he found that (1) the "respondent jobbers (petitioners here) are the real purchasers within the meaning of the Robinson-Patman Act, (2) that complaint counsel have failed to establish that the price differentials granted to SCJ were not cost justified, or that the jobber members knew or should have known the differentials were not cost justified and (3) complaint counsel failed to establish that the respondents (petitioners here) induced or received a discrimination in price"(3782-3818).

Accordingly, the Trial Examiner ordered that the complaint



be dismissed (3817-3818).

Complaint Counsel appealed to the Commission and on December 17, 1965, the Commission, by a majority vote, Commissioners Elman and Jones dissenting, reversed the Trial Examiner and entered a new cease and desist order (4047-4052).

This petition seeks to review this last order of the Federal Trade Commission.

### JURISDICTION OF THIS COURT

The several Petitioners conduct their businesses in the State of California (see Paragraph 1 of the Complaint, 6-20, incl. , admitted by Paragraph 1 of the Answer (28) and included in the findings of fact in the Initial Decision (35-45 Incl) ). This Court has jurisdiction of the proceeding and of all questions to be determined therein, by virtue of 15 U.S.C.A. 45(c), which reads in part as follows:

"(c) Any person, partnership, or corporation required by an order of the Commission to cease and desist from using any method of competition or act or practice may obtain a review of such order in the court of appeals of the United States, within any circuit where the method of competition or the act or practice in question was used or where such person, partnership, or corporation resides or carries on business, by filing in the court, within sixty days from the date of the service of such order, a written





petition praying that the order of the Commission be set aside. A copy of such petition shall be forthwith served upon the Commission, and thereupon the Commission forthwith shall certify and file in the court a transcript of the entire record in the proceeding, including all the evidence taken and the report and order of the Commission. Upon such filing of the petition and transcript the Court shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to make and enter upon the pleadings, evidence, and proceedings set forth in such transcript a decree affirming, modifying, or setting aside the order of the Commission, and enforcing the same to the extent that such order is affirmed, and to issue such writs as are ancillary to its jurisdiction or are necessary in its judgment to prevent injury to the public or to competitors pendente lite. "

### STATEMENT OF THE CASE

SOUTHERN CALIFORNIA JOBBERS, INC. is a cooperative corporation, duly organized under the laws of the State of California. Its Articles of Incorporation were filed December 6, 1935 (71, CX-2 2/).

Its principal place of business is located at 1621 East 27th

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2/ CX refers to Commission exhibit. RX refers to Respondents' Exhibit.



Street, Los Angeles, California (1984, 2042) where it maintains a warehouse of 37, 200 square feet of which 3, 000 square feet are devoted to office space (2042), and where it has thirty-seven employees, plus three more in supervisory positions (2042-3).

In the first quarter of 1964, the inventory in the warehouse was between \$573, 000. 00 and \$574, 000. 00 (2044; CX 226A & B).

At the time of filing the complaint, there were fifty-nine stockholder members of SCJ (35-45), each owning one share of stock (46). At the time of the second hearing, there were sixty-five stockholder members (2074). Each of these members is a jobber of automotive parts in competition with other jobbers (46), including both other members of SCJ (138, 806-807) as well as jobbers who are not members (138, 170, 499, 512, 519, 520, 529, 547, 550, 575, 587, 635, 641, 668, 683, 720, 726).

SCJ purchases merchandise from various suppliers and stocks that merchandix in its warehouse. These purchases are made at regular warehouse prices, that is to say, the same prices as are paid by other warehouses (204, 237, 273, 281, 286, 290, 295, 317, 329, 336, 340, 350, 351, 352, 353, 356, 387, 389, 391, 392, 393, 412, 449, 470, 472, 486, 487, 610, 613, 624, 627, 661, 663, 664, 691, 692, 693, 710, 832, 1114, 1116, 1263, 1278, 1290, 1378, 1433).

After the former order of this Court, SCJ discontinued all drop shipments (1205, 1206, 1378, 1433, 1889, 1933, 1934,





1939, 2021, 2077). There is no evidence to the contrary. <sup>3/</sup>

Mr. Jacobsen (1644) stated he knew that SCJ picked up merchandise and merely transferred it from one truck to another. But he was forced to admit that his knowledge was of an incident prior to October, 1962 which was the date of the earlier opinion of this Court (1646).

The Commission has found "that practice (drop shipments) apparently have been discontinued by S C J . . . " (4028).

The merchandise in the warehouse is paid for by SCJ and then sold to its jobber members in such quantities as they may order, SCJ performing the usual breaking of bulk and repackaging. Each member is billed for his purchases at jobber prices.

After deducting the cost of operation which is 6 or 7 per cent of the total, the remaining profit is credited to the members quarterly in proportion to their purchases of the several lines (2097-2098).

The Commission states "the price differentials in issue here at this stage are confined to the warehouse distributor's discount of approximately 20 per cent from the jobber's price granted the respondents by their suppliers" (4028).

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<sup>3/</sup> Although complaint counsel, at the opening conference, disclaimed any question of compliance (1005), he later stated (2117) that the minutes of SCJ contained "indirect evidence" that might be considered "drop shipments or not drop shipments".



## STATEMENT OF THE ISSUES

Petitioners contend that the cease and desist order of the Commission should be vacated and set aside and the complaint dismissed for the following reasons:

1. That there is no substantial or probative evidence to support the finding and conclusion that the jobber members, not Southern California Jobbers, Inc. , are the buyers of merchandise from the suppliers.
2. That complaint counsel utterly failed to support the burden of proof that the warehouse discount granted to Southern California Jobbers, Inc. was not cost justified.
3. That the Commission erred in failing to find and conclude that the distribution of net earnings to the stockholders of Southern California Jobbers, Inc. was within the exemption of Section 4 of the Robinson Patman Act.
4. That the order of the Commission in effect declares that a cooperative organization is per se an illegal organization which cannot be allowed to conduct business in the manner in which cooperatives have conducted business from time immemorial, and to that extent, the order is contrary to the law and the evidence and in excess of the powers granted to the Federal Trade Commission by the Congress.





# I

THERE IS NO SUBSTANTIAL EVIDENCE TO SUPPORT THE FINDING THAT THE MEMBER JOBBERS ARE THE PURCHASERS OF MERCHANDISE FROM THE SUPPLIERS OF SCJ.

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The Commission has found that the member jobbers of SCJ are the purchasers of the merchandise from the suppliers. The reasoning is that the cooperative is owned and controlled by the members through a Board of Directors and committees, that the sole purpose of the cooperative is to provide opportunities for advantageous purchasing that it sells to none except members, that the discounts are the property of the members and that SCJ acts as agent for its members.

This doctrine is an outgrowth of the decisions in the group buying cases where there was no warehouse and the individual orders of the members jobber was sent to the supplier who shipped directly to the member jobber. It was held in those cases that the jobber member was the purchaser and the supplier, the seller.

American Motor Specialties Co. v. F. T. C.

278 F. 2d 225 (2nd Circuit), Cert. Den.,  
364 U. S. 884.

In that situation, the particular merchandise could be identified on the books of the seller and those of the jobber member as being shipped directly from supplier to jobber, so there was some basis for the conclusion.

But here the situation is different. SCJ buys in large



quantities, usually carloads or truck loads. The merchandise so bought is delivered to the SCJ warehouse and becomes part of the warehouse stock. Complaint counsel, throughout the hearing, tried to imply that orders from SCJ jobbers were transmitted directly to the suppliers and that specific merchandise was delivered to the jobber member, merely by shifting the package from an incoming to an outgoing truck (2077, 2117). Complaint counsel were given access to all of SCJ's records of purchase and sale. They called for such of these records as they selected and examined them at length (2118-2120).

But not one scrap of evidence was introduced to support the thesis. The testimony of Mr. Huffaker (1939), Mr. Dixon (2077-8) and Mr. Kardas (2021) stands undenied -- there is no such practice in SCJ. All merchandise goes into the warehouse stock until an order is received.

RX 35 and RX 36 provide a good illustration of one month's transactions in the merchandise of one supplier, five purchases at a total cost of \$8774. 79 and two hundred sixty-seven sales for the total sales price of \$3771. 31. Not a single purchase, as shown by these records, can be matched with a corresponding sale to a jobber member

So every element of a sale, that is to say, specified goods, unit or total price and privity of contract is entirely missing as between a supplier and the jobber member. And not even complaint counsel has contended that a supplier could look to the individual member for his money.



Of course, it is vital to the Commission's case that the jobber members shall be considered the purchasers. In Alhambra Motor Parts v. F. T. C. , 309 F. 2d 213, this Court said:

"In answer to the Commission's complaint, petitioners advanced the defense of cost justification. Such a defense would not have been necessary, if S. C. J. rather than the jobber members had been found to be the buyer from the manufacturer" (5) Footnote 5: "In that event, since it was neither alleged, proved nor found that S. C. J. received a price discrimination as compared to competing warehouse distributors, no defense would have been required."

We submit that the mere fact that a corporation is controlled by its stockholders (as is every corporation and required by California law (Corporations Code §12600; 2105) is not enough to justify the holding that the jobber members are the purchasers from the manufacturers, especially when there is not one iota of evidence showing direct dealings between them.

It is to be anticipated that Commission Counsel will rely on the N P W and Monroe cases to support their argument on control. We believe these cases are distinguishable.

General Auto Supplies, Inc. , v. Federal Trade Commission 346 F. 2d 311 (CA-7).

This was a case of a limited partnership where the general





partner operated a warehouse in Atlanta and the limited partners were jobbers located in several states. About six per cent of the sales were made to jobbers who were not partners and 20 per cent of the sales were drop shipped to the limited partners.

The decision seems to be based on three factors:

- First: That there was such control by the limited partners as to hold that the partners were the buyers.
- Second: That the warehouse did not sell.
- Third: There was evidence to support a holding that the warehouse discount was not cost justified.

Monroe Auto Equipment Co. v. Federal Trade Commission, 374 F. 2d 401 (CA-7) Cert. Den.

Here, Monroe was charged with granting discriminatory prices to warehouses which in turn owned or controlled jobbing outlets. Cost justification was not pressed on appeal.

The jobbers were held to be the purchasers in a situation where one Hart owned a business which was both a warehouse and a jobbing outlet and three other jobbing stores. There were four other jobbing corporations with the same name. In each case, the same Hart was the principal stockholder, president and chairman of the Board.

In both cases, the Court rejected any argument based on the Crog decision.

Central Retail-Owned Grocers, Inc. v. Federal



This was a case of a cooperative which distributed its net earnings to its members, based on their purchases. The Commission charged that the distribution of earnings (which were part of the profits arising from the discount allowed the cooperative) were the equivalent of a brokerage or commission paid to a purchaser, and therefore a 2(d) violation. The Court rejected this contention, saying:

"It is apparent to us that the inference of the Commission to the effect that Central received commissions, brokerage or other compensation or allowances or discounts in lieu thereof from its suppliers was improperly drawn from comparisons of brokerage paid by such suppliers on sales which they made to brokers with the price reductions granted Central. The inference upon which the Commission's findings and order are based has no substantial evidence in the record to support it. Instead, the record convincingly shows that the payments made by Central to the suppliers were for merchandise which were bought upon its own credit and not upon orders of its members transmitted by it to the suppliers. The fact that Central, because of its strong purchasing power, was able to buy at favorable prices or upon discounts and allowances by its suppliers is not proof that Central was rendering a brokerage service. It



bought on its own order and on its own credit. It was billed by the suppliers and it paid the bills. . . . Reason does not permit our ignoring these facts in order to declare illegal, a worthy effort by a number of wholesale grocers, owned by retailers to reduce the ultimate sale prices to the consumer by entering into the arrangement with Central, which made them stronger in their competition with large chain stores." (Emphasis added).

And again the Court said:

"In the case at bar, the Commission would drive such groups out of existence."

The principles of the foregoing opinion apply to our case. Where the Court holds that there is no evidence to show distribution of earnings is an illegal (2(d)) brokerage, there is no evidence in Alhambra to show distribution of earnings by SCJ is an illegal (2(f)) discount granted by the suppliers.

We contend that N P W is not controlling here because (1) SCJ is a cooperative; (2) We have strong evidence of cost justification; (3) The indirect purchaser doctrine cannot be applied without putting the cooperative out of business; (4) SCJ sells more merchandise than comparable "independent" warehouses.

The Monroe case is distinguishable on similar grounds and also, we think, the case here is quite different from the Monroe situation where one man owned and operated both the warehouse and the jobbers.





We submit that the Commission cannot support its contention that distribution of cooperative earnings is an illegal discount to the jobber, any more than it could call it a "brokerage" in Crog.

If we are wrong in this contention, then Gulf and Western which operates 33 warehouses and 150 jobbing outlets is out of business. So is Colyears and so should be Crum and Lynn. Since the hearing in this case, the control of Crum & Lynn has passed to a manufacturer. And has there been any complaint filed against Featherstone whose president, Mr. Krumbholtz, testified (1835) that Featherstone tries to create "captive" accounts? Or against Chanslor & Lyon who finances jobbers(1594-5)?

Since the so-called independent warehouses have as much trouble selling customers of Colyears and Gulf and Western as to the members of SCJ (Livoni 1793), it would appear that there should be some action taken, if counsel are sincere in their argument that controls or vertical integration is forbidden (1155, 4102).

We think that A W D A has made the complaint against SCJ in a concealed attempt to drive a competitor out of business. As said by Commissioner Elman in his dissenting opinion (4091):

"Competition, in the antitrust sense, may be truly injured by a policy of law enforcement which preserves intact an inefficient, uneconomical and stratified system of distribution, and prevents the elimination of unnecessary middleman costs through the organization of cooperatives. 14/

"14/ As Corwin Edwards, a distinguished former



Chief Economist of the Commission, has pointed out in this context:

"Students of marketing generally agree that progress in distribution has lagged behind progress in manufacturing, that distributive methods are often wasteful, and that the opportunities to improve the efficiency of distribution are substantial. Accordingly, it is important to encourage rather than discourage experiment with distributive methods and distributive channels. Among the possibilities that might be explored are changes in the number of successful intermediate distributors and in the vertical extension of each, change in the kind and amount of distributive services rendered, and change in the number and variety of different distributive channels used. Prior to experiment, it would be rash to assert that the best system of distribution for industry generally or for a particular industry would be attained by an increase or decrease in vertical integration, by greater or less specialization in distributive function, by uniform or diverse methods of distribution. What is needed is opportunity to try various methods on competition with one another." Edwards, The Price Discrimination Law, 344 (1959).

The Commission, by its decision here, is aiding this



attempt to preserve a monopolistic situation, to keep all jobbers independent on warehouse distributors and to drive cooperatives to the wall (4078).

This intent will be disclaimed, but it is nevertheless true. Cooperatives cannot exist if deprived of both earnings and working capital.

Nor does it help the Commission to say that SCJ is only the agent of its members. Agent for what? Unless there is a specific transaction between supplier and jobber, there is no basis for any principal and agent relationship. In short, the agency argument begs the real question. Who is the purchaser?

Rowe, Price Discrimination under the Robinson-Patman Act (1962).

At Page 351, the author says:

"If the cooperative receives prices no lower than other distributors at the same functional level (even though lower than the price paid by unaffiliated distributors at the next level of distribution), no charge of discrimination could be raised but for the cooperative's affiliation with its members and their participation in its profits."

Mr. Patman himself indicates that the failure of a manufacturer to give a cooperative a warehouse discount, when the cooperative performs the functions of a warehouse distributor, would be an illegal discrimination in favor of the other warehouses.





See: A Complete Guide to the Robinson-Patman Act,  
1963 Edition, page 23.

We submit that only SCJ, not its members, can be considered the purchaser from the supplier. It alone names the quantity and specific part numbers and is alone obligated to pay for the goods purchased. This obligation is only that of SCJ, and not of its members individually or collectively.

Since Congress has not forbidden cooperatives, this so-called indirect purchaser doctrine is only an unwarranted seizure of power which has the effect of lessening competition among warehouse distributors.

## II

### THE EVIDENCE FAILS TO SUPPORT THE BURDEN OF PROOF THAT THE WAREHOUSE DISCOUNT GRANTED TO SOUTHERN CALI- FORNIA JOBBERS, INC. WAS NOT COST JUSTIFIED.

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The Commission has found as follows (4045):

"On the basis of the record as a whole, it is clear to a large extent SCJ's warehousing duplicated that locally performed by the manufacturer, and the cost savings, if any in sales to respondents, as distinguished from costs involved in sales to direct jobbers would not be significant -- certainly not sufficient to justify the price differentials of 20-plus per cent which are under consideration here. This conclusion is



particularly evident in the case of purchases from Standard Motor Products. " 4/

Bearing in mind that the burden of proof to prove that the warehouse discounts to SCJ was not cost justified, was on Complaint Counsel (See: Automatic Canteen Co. v. F. T. C., 346 U. S. 61; Alhambra Motor Parts, et al. v. F. T. C., 309 F.2d 213 (CA-9); Order, 4034), it is submitted that this finding is not supported by any substantial evidence. Rather, as said by Commissioner Jones (4098):

"The record in this case demonstrates that S. C. J., in its capacity as a warehouse distributor, performed this comprehensive selling function in all respects in a manner substantially identical to unintegrated warehouse distributors. The record in this case also clearly demonstrates that these warehouse distributor functions effect substantial savings to manufacturers."

First of all, the Commission's statement of the cost saving features (Order, 4034) ignores and omits entirely the function of purchasing, warehousing merchandise and breaking bulk. The order does pick out isolated remarks of various witnesses as to some individual items but, on the whole, ignores other testimony

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4/ The only testimony about Standard Motor Products is that of Alex Stern (175-229) given on June 22, 1959 and describes Brokerage business as does prior to that date. This has been entirely discontinued and all merchandise now goes through the warehouse.



of these same witnesses, all of whom were called by Complaint Counsel. Also, the Order draws comparisons between services rendered to independent jobbers and to SCJ members, overlooking the clear testimony of these same witnesses, that the customers of all warehouses got the same service and attention.

We will review the testimony of all the witnesses on this point. Mr. Bolander is quoted (1099-1102) as calling on SCJ jobber members at least as often as on independent jobbers.

But this witness also said (1116):

"Q. Do you render to SCJ any services that you do not render to the other warehouse?

"A. No. They receive the same services, the other warehouse as I give SCJ.

"Q. In other words, there is no advantage in favor of SCJ?

"A. No. That is correct.

"HEARING EXAMINER LEWIS: Do they perform the same services as the other distributor?

"THE WITNESS: As the other warehouse?

"HEARING EXAMINER LEWIS: The other warehouse distributors.

"THE WITNESS: Yes, they do.

"HEARING EXAMINER LEWIS: Do you call on the customers of the other warehouse distributors?

"THE WITNESS: Yes I do, your Honor.

"HEARING EXAMINER LEWIS: To the same



extent as the SCJ jobber members?

"THE WITNESS: Not to the same extent.

"HEARING EXAMINER LEWIS: What is the difference?

"THE WITNESS: Sales to SCJ members are greater, so I would spend more time with the SCJ jobbers."

Mr. Bolander also said that the SCJ warehouse saved Thermoid money (1086). If it did not exist, Thermoid warehouse requirements would be greater (1089); that the merchandise would not move as rapidly (1091); that SCJ performs the same services that he and his staff do for direct jobbers (1104); that sales through SCJ warehouse are satisfactory (1110); that the Annual Sales Meeting helps sales "tremendously" (1111); that SCJ effort saves time and money (1112); that when SCJ picks up at Thermoid, all freight is saved; that SCJ orders are substantially larger and larger orders are more economical; that SCJ carries a satisfactory stock of \$10 - 15,000.00 (1113); that SCJ redistributes catalogs and price lists (1118); that SCJ sales meetings are of substantial assistance in making sales (1119); that a warehouse distributor can deliver faster (1121); that fast delivery assists in making sales and saves money to Thermoid; that SCJ does everything a warehouse distributor should do (1123, 1136).

Mr. Fleer, of American Hammered, is quoted as calling on SCJ members the same as on direct jobbers of comparative size





(1213).

He also said that his salesmen call on all warehouse distributor jobbers customers the same as on the direct jobbers if they are large enough, based on potential volume (1160, 1214, 1290); that before using SCJ, he sold out 12 SCJ members as direct jobbers (1219) and SCJ got many new accounts for him (1225); that SCJ members "seem to know our programs before we get there" (1224); that SCJ does save money for American Hammered because, "we seem to be able to do a larger volume of business with less effort" (1230); that SCJ has a suitable building (1291) and stock of about \$20,000.00 (1292); finds SCJ jobbers adequately stocked (1293). No freight on SCJ sales, they pick up everything at our warehouse and that represents a substantial saving (1294); SCJ selling efforts assists sales and decreases selling expense (1294); SCJ assists in selling new members (1297); on catalogs SCJ is treated like all others (1298); was selling 10-15 SCJ members, but after putting merchandise in the SCJ warehouse, he sells 36 of them, a substantial increase (1298); the sales force was not increased (1299) but volume was: he is pleased with sales made through SCJ (1300); and at this point event Complaint Counsel seems to concede that a warehouse distributor that sells (a satisfactory volume) saves the manufacturer money (1310).

Mr. Chadwick of Standard Motor Products, is quoted as saying calls are made on SCJ jobbers with the same frequency as on any other jobbers (2031). This includes jobber customers of all his warehouses and irrespective of calls by warehouse salesmen



(2036), his calls include the jobber customers of Chanslor & Lyon and Mopex (2035). He also said that sales expense was not reduced by selling through SCJ or any other warehouse (2036-7). (This, however, does not include comparative volume of sales for a given period of sales effort.) Then he said the volume of sales through the SCJ warehouse was satisfactory (2037); that the SCJ account was the largest in the area (2040). From this, it appears that SCJ does a better selling job than Chanslor & Lyon in spite of their ten and one-half salesmen (Humphries 1514).

Mr. Costello, of Republic Gear Co., is mentioned to support a statement that salesmen call on SCJ jobbers or indirect jobbers regularly (1412) and that jobbers in area regularly pick up merchandise at Republic's warehouse (1406-7).

This witness also said, we do a little more for the independent jobber (1395); we don't spend the time with an indirect jobber as with a direct jobber (1396); was selling 12-14 SCJ jobbers (1401) but after his line was put in the SCJ warehouse, he is selling 90% of the member jobbers (1423); that various SCJ services save money for Republic (1415); that SCJ stock of \$20 - 25,000.00 is comparable to other warehouses (1421); that SCJ volume of sales is greater than the others (1422); that volume of sales rather than number of salesmen is the important thing (1422); that SCJ has increased our sales "exceptionally so" (1423); that SCJ helped him to get new outlets (1423); that SCJ stock increases Republic's merchandise without expense to Republic, that increased exposure helps sales and saves money; that he spends more time trying to



sell independent jobbers (1424); that SCJ open house helped increase sales (1425); that SCJ handling obsolescence saves manpower and freight (1430); that SCJ picks up all merchandise at the warehouse, thus Republic pays no freight (1432); that sales lunches helped sales (1433); that SCJ sells several thousand dollars worth of obsolete merchandise which saves cost of freight back to factory (1443); that SCJ bulletins help sales (1449).

Mr. Milligan, speaking of Dutch Brand, said many customers pick up merchandise at the warehouse (1359). He also said his warehouse would not break cases (1340); that a warehouse distributor would break cases to supply a jobber with 6 rolls of one and 4 of another; that the product is semi-perishable and deteriorates in hot weather (1340); a warehouse distributor can keep a jobber supplied without over stocking (1341); SCJ picks up merchandise, so no freight (1358); that he calls on all W D customers jobbers the same (1363-4); that SCJ distributes catalogs to its customers (1359); that SCJ saves money by buying case lots and selling piecemeal; that a public warehouse will not break cases and it costs money to break cases (1367); that there is a great saving in obsolescence and defective material (1370); quicker turnover in a warehouse eliminates obsolescence (1371); SCJ maintains an adequate stock (1374-5); larger than average, as SCJ does best volume (1375) and he sells to 12-15 warehouse distributors in Southern California (1334); that SCJ gives adequate sales help (1375).

William Webster, District Manager Federal Mogul. This





witness is referred to in the Order for the proposition that direct jobbers, if in close proximity to the Federal Mogul warehouse, pick up their merchandise as does SCJ (1259-60). This, it is argued, shows that SCJ pick up does not save any money. This conclusion is not sound because SCJ picks up for many jobbers who are not "in close proximity" to the warehouse. Their members are located from Fresno to the San Diego area (2045).

Mr. Webster is also cited for the proposition that his catalogs were distributed to all jobbers by direct mail (1261-62) which has never been denied.

This witness also testified that his sales increased after his products were sold through SCJ (1254); that he couldn't say how much was saved by selling through SCJ (1267), but he sold them, anticipating higher volume and got it (1272); that SCJ carries a \$50,000.00 inventory and does an adequate job of reselling (1272); that SCJ generally gives larger orders than other warehouse distributors and larger orders are more economical and represent savings to Federal Mogul (1274); that the SCJ sales effort saves him time as he doesn't spend as much time (1275); that SCJ pickup at Federal Mogul warehouse saves freight (1276); that SCJ stock frees Federal Mogul from filling small orders (1277); that availability and fast delivery is an advantage to the manufacturer (1278); that he formerly sold 65% of SCJ members, now sell 85-90% (1279); that his volume of sales has increased 35-40% (1280); none of his customers print catalogs (1281); all warehouse distributors, including SCJ, are supplied from the local warehouse (1283); that



the SCJ open house and sales lunches make all SCJ members available (1287) and both save him a lot of time (1288).

The Order quotes witnesses Huffaker (1940), Krumbholz (1826) and Tatum (1476-77) for the proposition that public warehouses charge 5-6% of sales and conclude that SCJ's warehousing could save the manufacturer no more. It is also said that "it is not clear" to what extent these manufacturers' warehouse break bulk. This conclusion is wholly unjustified. In the first place, the merchandise in the public warehouses and the manufacturers' warehouse still belongs to the manufacturer, whereas SCJ has bought and paid for the merchandise in its warehouse. And, as testified by the manufacturers' representatives as set out hereinabove, all the warehouse distributors buy from the local warehouses. Webster (1283) Milligan says: Our warehouse (1340) and public warehouses (1367) "do not break bulk" and that he wants to sell warehouse distributors because they can sell the jobber without overstocking (1341); that 65-70% of sales to warehouse distributors are made through the local warehouse; Republic Gear has its own warehouse which serves all the warehouse distributors in Southern California, including SCJ; Costello (1408); all Thermoid customers in the Los Angeles area are served from the local warehouse, including all warehouse distributors; Bolander (1082). So are the warehouse distributor customers of American Hammered Fleeer (1203). See also Morris Brown (461).

So much for the manufacturer people -- they all say that warehouse distributors in general and SCJ in particular save money



for the manufacturers.

Witnesses from other warehouses are of the same opinion.

Warehouse distributors save the manufacturers money (1461) and again "We do business with a lot of small orders and shipments that a normal warehouse doesn't have to put up with and we have a lot more returns to stock than a normal warehouse would have to put up with" (Tatum 1480).

In passing, this warehouse has only one real salesman as Mr. Tatum says, the other three are just order takers (1507).

Mr. Humphries, of Chanslor & Lyon, testified as follows, at page 1552:

"Q. Do you actually earn this 20 per cent by what you do for those that give it to you?

"A. Yes sir, I certainly believe we do. I don't believe that a manufacturer could do the selling that we do, perform the functions that we perform, carry the credit that we carry, bear the expenses of collection to which is attendant upon credit and do it as efficiently and as cheaply as we do. " 5/

Humphries also said warehouse distributors do much more than a fee warehouse (1561); that these services save money for the manufacturer (1584); that the sales effort saves money (1585);

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5/ If it be argued, he is speaking only of Chanslor & Lyon, SCJ seems to outsell Chanslor & Lyon in the same lines (Chadwick (2040), Costello (1422), Webster (1274)) and so must save as much for the manufacturer.



carrying credit assists the manufacturer as it reduces the capital he must have in his business (1596); stock in warehouse saves money for manufacturer and helps increase sales (1609); sale of returned merchandise also helps (1609); those services fully justify the warehouse distributor's discount (1610).

Mr. Jacobson, President of Chanslor & Lyon, was not questioned on cost saving but he did say not all SCJ jobbers take the line because they have a better deal elsewhere (1654) and that the service given by SCJ members is what Chanslor & Lyon pays for (1662).

Paul Livoni of Crum & Lynn and President of A W D A, said at page 1718:

"Q. Do you earn it by way of what you do for those who give it to you?

"A. We sure think we do. We work awfully hard for it."

And further that services save money for the manufacturer (1733); the warehouse eliminates credit problems for the manufacturer (1733); that warehousing merchandise saves manufacturer money as it gives him a shipping and billing point nearer the customer (1774).

On the question of where the warehouse shall purchase, Mr. Livoni says the manufacturer determines whether it shall be the local warehouse or the factory (1775).

Sales efforts save substantial amounts (1778); maintenance





of warehouse stock assists manufacturer in getting greater volume of sales, breaking bulk, repackaging and shipping saves manufacturer money; it is more economical for a warehouse distributor to do this because he can combine smaller orders (1779). He further says Fram said SCJ could produce more volume (1784); that a warehouse distributor requirements (1785) would save the manufacturer money (1786); that he believes Crum & Lynn earns its discount (1786) on annual sales volume in Los Angeles area of \$1,750,000.00 (1791).

This is about half of SCJ's volume (\$3,378,048.00 CX 225) from a warehouse of about the same size (SCJ - 37,200 square feet (2042), Crum & Lynn - 30,000 square feet and 8,500 square feet (1711)).

Robert L. Krumbholz, President Featherstone's, Inc. This witness is referred to (1826) establish the average fees charged by a public warehouse and his average turnover (1801).

Featherstone has an inventory of \$750,000 in a Los Angeles warehouse containing 42,000 square feet (1797). This warehouse gets a 20% off jobbers list because,

"We buy from the manufacturer. We warehouse the merchandise. We sell to the wholesaler, to the jobber. We ship to the jobber. We sell to the jobber. We have salesmen in the field." (1797).

On cost saving to the manufacturer, he also said at (1833):

"Q. Does the warehousing of merchandise



save the manufacturer money?

"A. Yes, sir.

"Q. A Substantial amount?

"A. Yes sir. "

And again the witness testified that when a warehouse buys in carloads or truck loads, it saves money for the manufacturer as compared to processing smaller orders (1834), and again that the real test of savings to the manufacturer is the volume of sales (1839).

William Steritz, of Car Controls, Inc.

This witness has a warehouse of 15,000 square feet (1843) with an inventory of \$485,000 (1852) with annual sales of four or five times that (1843) or from \$1,940,000 to \$2,425,000.

On the question of cost justification, this witness gave no significant testimony.

Jerry Lipscomb, a manufacturer's representative, was called to criticize SCJ's selling effort (1872) (1875). But he also said SCJ is a "prestige account" (1871) and that a competitor was spending more money than he could (1873, 1876, 1882) and the real trouble was that his supplier, Columbus, was having problems (1878), that a change of manufacturers made his customers, including SCJ members, unhappy (1878); that failure to get the program off the ground was largely due to failure of Columbus people and that he was trying to sell SCJ other lines and he felt SCJ could give satisfactory service (1878).



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There was nothing said about cost justification.

Carroll Wissler, Factory Representative of Sterling Aluminum.

The witness criticized the selling and servicing of the accounts by SCJ (1891).

However, sales to SCJ were discontinued in 1960 (1890). He also said when selling SCJ he had an agent and,

"I don't think the agent did his job or these things wouldn't have occurred" (1899)

and again that he made later sales calls on SCJ to see if they were interested in Sterling's proposition (1900-01), although Sterling was not in a position to take on a new distributor because of production trouble (1903, 1906).

This witness said nothing about cost justification.

Whitley Huffaker, President of SCJ, was not questioned about cost saving.

John F. Dixon, General Manager of SCJ, was not examined on cost savings as such but he did identify the exhibits (RX 36, A-L), detailing the business done with Stant Manufacturing Co. during the month of January, 1964.

These exhibits show a typical account and the individual purchases and sales and demonstrate more clearly than words, how the breaking of bulk packages and making small sales to jobbers involves substantial costs. It cannot be denied that if the supplier had made the same sales to the jobbers, its cost of invoicing and and packaging would have risen sharply (50 times at least) if,



indeed, the supplier would have accepted the orders at all.

There were five purchases on three days out of the month:

<u>Exhibit No.</u>	<u>Date</u>	<u>Amount</u>
RX 36-H	January 7, 1964	\$1,523.01
RX 36-G	January 7, 1964	479.40
RX 36-G	January 16, 1964	599.25
RX 36-F	January 16, 1964	479.40
RX 36-B & C	January 22, 1964	5,693.73
		<u>\$8,774.79</u>

During this period, there were 267 separate sales made by SCJ. Analysis of RX 35 A-Z, 1-242 shows:

Total sales price (Jobbers prices)	\$3,771.31
Average Invoice	\$ 14.02
Maximum Invoice (RX 35 Z-246	\$ 369.55
Minimum Invoice (RX 35 Z, 153 & 156)	\$ .19

Those sales invoices were divided as follows:

<u>Number of Sales</u>	<u>Over</u>	<u>Under</u>
15		\$ 1.00
38	\$ 1.00	2.00
63	2.00	5.00
59	5.00	10.00
80	10.00	50.00
8	50.00	100.00
<u>5</u>	100.00	
267 Total		



Lastly, there is practically no evidence on how much of SCJ's merchandise is purchased locally. True, Mr. Dixon said he favored short supply lines. But he also said at (2051):

"Q. From what sources geographically speaking, does SCJ obtain the merchandise which it sells to (sic) its warehouse?

"A. All the way from the extreme East Coast, Long Island City, so far as I know is the farthest one east, and all points between, plus local factory warehouses in the immediate area.

"Q. Now, what determines whether you purchase from a factory warehouse located outside this area or from a local warehouse?

"A. The manufacturers."

Mr. Livoni, of Crum and Lynn, agrees to this (1775) and there is no testimony to the contrary.

On this evidence, we submit that the statement that SCJ merely duplicates that locally performed by the manufacturers and cannot save them any significant amount, is wholly unsupported by the record.

We believe the uncontradicted evidence on this point establishes beyond any doubt that the warehouse service of SCJ (and the other warehouse distributors) saves substantial sums for the manufacturers. There is no evidence as to how much is saved but the Complaint Counsel had this burden, not the respondents. Since



it is undisputed that other warehouse distributors get the same discount as SCJ, it would appear it is generally accepted throughout the industry, that warehouse distributors earn their money.

It is agreed that SCJ had no sales force, yet SCJ sold a satisfactory volume of merchandise; in fact, several witnesses have said it was the largest customer (Chadwick, 2040); Costello, 1422; Milligan, 1375; Webster, 1274), "a prestige account" (Lipscomb, 1871) and, as we will point out, the majority opinion seems to complain that our sales volume is so great it is evidence of another form of violation. Other warehouses have no salesmen (1227; 1245; 1308) (346) (1348-9). Their owners and officers do the selling. So do the officers and members of SCJ.

About the only other evidence, is to the effect that manufacturer salesmen call on SCJ jobbers about as much as on their direct jobber accounts. But these witnesses also said they call on the customers of their other warehouse distributors exactly the same (Bolander, 1116; Fleer, 1160, 1214, 1290; Chadwick, 2031, 2035, 2036; Milligan, 1363-64). The other two call on direct jobbers more than on SCJ jobbers (Costello, 1345-6; Webster, 1275).

If the burden of proof had been on petitioner, we think the Commissioner, and rightfully so, would have pushed this evidence aside. Their own rules and practice would have demanded it.

See: Automatic Canteen Co. v. Federal Trade Commission, 346 U.S. 61, 73 S. Ct. 1017.

At page 68, the Supreme Court said:

"The elusiveness of costs data which apparently





cannot be obtained from ordinary business records is reflected in proceedings against sellers. Such proceedings made us aware of how difficult these problems are, but this record, happily, does not require us to examine cost problems in detail. It is sufficient to know that whenever costs have been in issue, the Commission has not been content with accounting affidavits; a study seems to be required involving perhaps stop-watch studies of time spent by some personnel such as salesmen or truck drivers, numerical counting of invoices or bills and in some instances of the number of items or entries of such records or other quantitative measurement of the operations of a business. "

The evidence in this case not only fails to meet the foregoing standards but arrives at a result contrary to the universal practice, since it says that the warehouse discount is not justified.

Under the foregoing circumstances, we submit Complaint Counsel have utterly failed to establish that the SCJ warehouse discount is not cost justified and the contrary finding by the Trial Examiner must be restored.



### III

THE COMMISSION ERRED IN FAILING TO  
FIND THAT THE OPERATION OF SCJ WAS  
WITHIN THE EXEMPTION OF §4 OF THE  
ROBINSON-PATMAN ACT.

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Section 4 of the Robinson-Patman Act (15 U. S. C. A. §13b: Act of June 9, 1936, 592 §4; 49 Stat. 1528) reads as follows:

"Nothing in this Act shall prevent a cooperative association from returning to its members, producers or consumers the whole, or any part of the net earnings or surplus resulting from its trading operations, in proportion to their purchases or sales from, to or through the association."

It is to be noted that the formal findings of fact, conclusions of law and order, does not mention this point. The Opinion of the Commission by Commissioner McIntyre, supported by Chairman Dixon and Commissioner Reilly, pushes the argument aside by saying the exemption extends only to a lawful activity (4075-6).

This we submit is bootstrap reasoning. The authorities do not support the conclusion reached by the Commission.

In American Motor Specialties, Inc. v. F. T. C., 278 F. 2d 225 (2nd Cir.), cert. den. 364 U.S. 884, there was a buying group with no warehouse. The business was carried on by drop shipments from the suppliers directly to the jobbers. This, it was said, meant that the jobbers were buying in the same quantities and in



the same manner as they did before joining the cooperative and thus, did not perform the warehouse function. Hence, the granting of the volume discount itself was illegal.

Mid South Distributors v. F. T. C., 287 F.2d 512 (5th Cir.), cert. den. 368 U.S. 838 was to the same effect.

In Quality Bakers of America, Inc. v. F. T. C., 114 F.2d 393 (C. A. 1), there was a commission paid by the seller to the buyer, a violation of 2(c).

But in this case, the situation is completely different. There is no illegality, even on the Commission's own theory, until the earnings are distributed.

SCJ operates a warehouse which the Trial Examiner found (3815) was substantially equivalent to the so-called independent warehouses. Commissioner Jones agreed (4098).

The discounts granted to SCJ are the same as those given to all warehouse distributors. So there is no discrimination at this point.

SCJ sells its merchandise at jobber prices and so do the other warehouse distributors. Again, there is no discrimination shown yet.

It is only when SCJ grants a credit to its customers at the quarter's end, that the Commission makes any complaint; in short, they hold that the distribution of earnings itself is the offensive act and this is exactly what Section 4 says in plain language is not to be prevented.

Nor does it help the Commission to adopt their artificial



theory that the jobber members are in fact the purchasers from the suppliers, because §4 clearly contemplates sales by the cooperative to its members and a trading profit resulting therefrom. As said by Commissioner Elman in his dissenting opinion (4088) "unless §4 provides such an exemption, it has no meaning at all".

We concede that §4 is not a blanket exemption and does not cover a violation of the Robinson-Patman Act. If a supplier paid the cooperative or one of its members a commission (a violation of 2(d)), <sup>6/</sup> there is no doubt that §4 does not prevent prosecution, but where the distribution of profits is the one indispensable element of the alleged offense, and without which, there is no suggestion of violation. Congress has said this is not to be prevented. The Order, therefore, is in direct contradiction with the statute.

Therefore, even if all other points have been decided adversely, §4 requires that this complaint be dismissed.

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<sup>6/</sup> An example of such a commission appears on page 1659 -- paid by one of the "true" warehouses.





#### IV

THE ORDER OF THE COMMISSION IN EFFECT  
DECLARES THAT A COOPERATIVE OPERA-  
TION IS PER SE AN ILLEGAL OPERATION  
WHICH ~~CANNOT~~ BE ALLOWED TO CONDUCT  
BUSINESS IN THE MANNER IN WHICH COOP-  
ERATIVES HAVE CONDUCTED BUSINESS FROM  
TIME IMMEMORIAL, AND TO THAT EXTENT,  
THE ORDER IS CONTRARY TO THE LAW AND  
IN EXCESS OF THE POWERS GRANTED TO  
THE FEDERAL TRADE COMMISSION BY THE  
CONGRESS.

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The underlying theory for the majority decision is that a cooperative is illegal; SCJ is a cooperative, therefore, SCJ is illegal, and there is nothing that can be done to cure the situation.

It is not expected that this theory will be admitted but it is nevertheless, true.

All the evidence presented was only to bolster this theory by showing every detail where SCJ differed from an imaginary norm. In most instances, it developed that other warehouses did the same things.

SCJ is condemned for not having a sales force. Yet SCJ gets a most satisfactory volume of sale. In addition to the evidence mentioned in Chapter II, there was complete agreement among the warehouse witnesses that the volume of sales, and not the method, was the important thing (Tatum, 1502; Humphrey, 1586-8; Livoni, 1767; Krumbholtz, 1830, 1839).

SCJ seems to outsell the other warehouses (Milligan, 1375; Costello, 1422; Chadwick, 2040). It also secures new customers for its suppliers (Bolander, 1110; Fleer, 1225, 1227, 1300, 1306,



1321; Webster, 1272, 1279, 1280; Milligan, 1375; Costello, 1422-3; Chadwick, 2037).

And other warehouses had no more salesmen (1154, 1227, 1308, 1346). Obviously, more salesmen could not affect the legal conclusions drawn by the Commission.

Much is said about the control exercised by the members. True, many members put much time and effort into running the business for which they are not paid (2053). This is one large item in their comparative cost reduction (1662).

SCJ is castigated because it asked the opinion of its members before putting in a line of hard parts (4030). But other warehouses also survey their customers (Jacobsen, 1655; Livoni, 1783).

It is said that SCJ warehousing is "pro forma" in nature (4040) because of high turnover. It would seem that SCJ is now held at fault for too good a sales record.

The real argument seems to be that (1) because of the cooperative organization, SCJ and its members are one (4034); (2) that this makes the jobber members the purchasers; and (3) then the distribution of corporate earnings is a discount.

In essence, the majority opinion forbids vertical integration. Again, this is a fault in SCJ, but not for other warehouses. Mr. Tatum of Mopex owns a jobbing store (1506), Colyears has its own stores (Humphries, 1564-5); so does Gulf and Western (Humphries, 1565). <sup>7/</sup>

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<sup>7/</sup> The Wall Street Journal of July 6, 1966 reports that Gulf & Western operates 33 auto parts warehouses and 159 auto parts jobber outlets.



Crum and Lynn has difficulty selling to Colyears or Gulf and Western customers (Livoni, 1793). 8/

Since no complaints have been filed against these operations, it would seem that vertical integration is only a fault in a cooperative.

We believe the record fairly shows that this entire controversy is an attempt by A W D A to drive all cooperatives out of business and appropriate their customers (See Commissioner Elman, 4079, 4091).

We do not believe that Congress has forbidden either cooperatives, or vertical integration.

See: Report of House Judiciary Committee.

H. R. Report No. 2287: 74 Congress 2nd  
Session (1936).

Here it was said:

"Any physical economies that are to be found in mass buying and distribution, whether by corporate chain, voluntary chain, mail-order house, department store, or by the cooperative grouping of producers, wholesalers, relailers or distributors . . . and whether these economies are from more orderly processes of manufacturing, or from the elimination of unnecessary salesmen, unnecessary travel expense, unnecessary warehousing, unnecessary truck or other forms of

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8/ Since the hearing in this case, Crum & Lynn has been purchased by a manufacturer.



delivery or other such causes . . . none of them are in the remotest degree distributed by this bill." (Emphasis added).

As said by the Attorney General's National Committee to Study Anti-Trust Laws (1955).

Report of Attorney General's National Committee  
to Study the Anti-Trust Laws (1955).

"To relate discounts or prices solely to the purchaser's resale activities without recognition of his buying functions thwarts competition and efficiency in marketing. It compels affirmative discrimination against a substantial class of distributors, and hence serves as a penalty on integration. If a businessman actually fulfills the wholesale function by relieving his suppliers of risk, storage, transportation, administration, etc., his performance, his capital investment and the saving to his suppliers are unaffected by whether he also performs the retailing function or any number of other functions. A legal rule disqualifying from discounts, recognized wholesale functions actually performed, compels him to render these functions free of charge. The value of the service is pocketed by the seller who did not earn it. Such a rule proclaims as a matter of law that the integrated wholesaler-retailer cannot possibly perform the wholesaling function; it forbids





the matter to be put to proof." (Emphasis added).

In a recent release, the Commission seems to have approved a similar idea.

See: Advisory Opinion Digest #13 CCH Trade Reports,  
Paragraph 17431 (1966).

A promoter was advised there are no actionable trade restraints in a proposed plan for discount-buying membership organization which involved members paying an annual fee and allowed to buy merchandise at a state discount from the prevailing price of retail merchants. Although membership was open to anyone of the public who pays the fee (as is membership in SCJ), what about the competitive effect on the retailers whose prices are undercut?

Nor does the complaint section seem to object to a form of vertical integration resulting from captive jobbers which seem to be cultivated by some independent warehouse distributors (1567, 1805, 1835).

There are other items also. SCJ is in the wrong for buying locally (4040). This is open to all warehouses (1666) and anyhow, it is the manufacturer who determines whether the W D buys from the local warehouse or the factory (Livoni, 1755; Dixon, 2051).

Dating to SCJ seems to be wrong (2005-6); yet it is the general practice when putting in a new line (Humphries, 1541; Livoni, 1753; Steritz, 1845-6).

SCJ has an inventory of \$573,000 to \$574,000 (4031), yet



the warehousing of the merchandise is ignored when stating the areas of saving money (4034). This inventory and size of the warehouse compares favorably with other warehouses but again it seems that the cooperative form of organization poisons the transaction.

We submit that there is no basis for condemning a cooperative or other form of vertical integration, and that the lack of complaints against the other organizations emphasizes that this Commission is trying to put cooperatives out of business rather than to eliminate vertical integration.

### SUMMARY

We submit that the evidence shows without contradiction the following:

SCJ is a cooperative organization, that it owns and operates a warehouse of 37,200 square feet in which it has an inventory of merchandise valued at more than \$570,000. This inventory was purchased in large amounts at the regular warehouse discount. SCJ got no discounts or services not given to all warehouses.

That although some drop shipments were available, SCJ has not had any drop shipments since the former order of this Court became effective.

SCJ breaks bulk and resells its merchandise to its members at jobber prices.

SCJ performs substantially the same services as other



warehouses and maintains a volume of sales which compares favorably with other warehouses.

While there is no evidence of the exact savings to the suppliers, all the evidence shows that the warehouse service does save the manufacturers or suppliers substantial sums, and that an average discount of 20% of jobbers' prices is used throughout the trade. Therefore, the Commission has failed to show that the warehouse discount granted to SCJ (and others) is not cost justified.

That, after deducting costs of operation, SCJ credits its remaining net profit arising from its trading operations, to its members in proportion to their purchases.

We contend on this evidence:

1. There is no discrimination;
2. There is no sound basis for calling the members the purchasers from the suppliers;
3. That there can be no inference of illegality drawn from the cooperative form of corporation;
4. Since the only possibility of price discrimination depends on the distribution of net earnings of a cooperative, such distribution may not be held to be the wrongful act itself as it is within the protection of Section 4.

We believe the complaint must be dismissed on any one of these contentions.

Respectfully submitted,

HARRIS K. LYLE

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Of Counsel  
LYLE & DI GIUSEPPE



CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Harris K. Lyle  
HARRIS K. LYLE





**In the United States Court of Appeals  
for the Ninth Circuit**

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**ALHAMBRA MOTOR PARTS, ET AL., PETITIONERS**

*v.*

**FEDERAL TRADE COMMISSION, RESPONDENT**

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**On Petition to Review and Set Aside an Order of the  
Federal Trade Commission**

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**BRIEF AND APPENDIX FOR RESPONDENT**

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 20,764

ALHAMBRA MOTOR PARTS, ET AL., PETITIONERS

*v.*

FEDERAL TRADE COMMISSION, RESPONDENT

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**On Petition to Review an Order of the  
Federal Trade Commission**

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**BRIEF FOR RESPONDENT**

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This case is here for the second time. It arises upon a petition to review an order to cease and desist issued by the Federal Trade Commission following this Court's remand of the proceeding to the Commission for further consideration of certain issues, hereinafter discussed, *Alhambra Motor Parts et al. v. Federal Trade Commission*, 309 F.2d 213 (9th Cir. 1962). Petitioners are charged with violating Section 2(f) of the Clayton Act as amended by the Robinson-Patman Act, 49 Stat. 1527, 15 U.S.C. 13(f), by the inducement and receipt of dis-

criminatory prices prohibited by Section 2(a) of that Act.<sup>1</sup>

## JURISDICTION

The Commission's jurisdiction of the petitioners and the subject matter is by virtue of Section 11(a) of the Clayton Act, 73 Stat. 243, 15 U.S.C. 21(a) (Appendix A, *infra*, p. 2a). The jurisdiction of this Court rests upon Section 11(c) of the Clayton Act, 73 Stat. 243, 15 U.S. 21(c) (*Id.*, at pp. 2a-3a), and by virtue of the undisputed fact that petitioners reside and carry on their businesses in the State of California (Pet. br. p. 3) and utilize the challenged practices within the jurisdictional area of this Court.

## COUNTERSTATEMENT OF THE CASE

### Proceedings before remand

The order to cease and desist which is the subject of this review was issued by the Federal Trade Commission at the conclusion of hearings following this Court's decision of October 9, 1962, and order of remand of November 15, 1962, in this Court's docket No. 17222 entitled *Alhambra Motor Parts, et al. v. Federal Trade Commission*, 309 F.2d 213. In its complaint (Apdx. 3-27),<sup>2</sup> issued September 17, 1957, the Commission charged that petitioners had violated

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<sup>1</sup> Pertinent portions of these and other statutory provisions are printed in Appendix A to this brief.

<sup>2</sup> "Apdx" refers to the printed transcript of record filed in Docket No. 17222.

Section 2(f) of the amended Clayton Act by inducing and receiving discriminatory prices prohibited by Section 2(a) of that Act. The complaint alleged that petitioners were automotive parts jobbers and that for the purpose of receiving discriminatory lower prices they had formed a cooperative purchasing organization, Southern California Jobbers, Inc. ("SCJ"), through which they asserted their combined bargaining strength and induced favorable prices, discounts and allowances (Apdx. 22). The complaint also alleged that the prices, discounts and allowances were not made available to competing jobbers on products of like grade and quality by the sellers, and that the purchases in question occurred in interstate commerce and tended substantially to lessen, injure, destroy, or prevent competition with petitioners (Apdx. 25).

In their answer (Apdx. 28-34), petitioners conceded the element of interstate commerce and competition with other jobbers in the purchase and resale of products of like grade and quality, but denied that the prices received were discriminatory and illegal under the Act.

At the conclusion of the hearing, the examiner issued his decision (Apdx. 35-64) in which he concluded that petitioners had violated Section 2(f) in the receipt of quantity discounts and redistribution discounts from suppliers. The examiner found that the jobber-members of SCJ were in fact the purchasers from the manufacturers of automotive parts and had knowledge that they had induced and received illegal price discriminations that could not be cost justified,

and he entered an order to cease and desist (Apdx. 59-64). Petitioners appealed to the Commission and the Commission adopted the examiner's initial decision as its own without further opinion (Apdx. 65-66).<sup>3</sup> Petitioners then filed a petition for review with this Court in which they conceded that, in view of recent court decisions, the quantity discounts received in so called "brokerage" transactions (in which goods are drop-shipped from the supplier to the jobber-member) violated the Act. They did challenge, however, the Commission order insofar as it related to redistribution discounts received on goods actually warehoused by the cooperative.

On October 9, 1962, this Court rendered its decision and on November 15, 1962, issued its order affirming and enforcing the Commission's order except as to "purchases on which petitioners perform a warehousing and distribution service." It remanded the case to the Commission for further proceedings "not inconsistent with the opinion of this Court." The Court ruled that insufficient attention had been paid by the Commission to possible cost savings resulting from the warehousing function performed by SCJ. While noting that the "operation was characterized in the record as an 'occasional' method of doing business of comparatively 'recent' origin," it observed that the record showed that by 1958 the volume of SCJ's warehousing transactions exceeded that of its brokerage transactions. After discussing

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<sup>3</sup> The examiner's decision and the Commission's order in the original proceeding are reported at 57 F.T.C. Rep. 1007.

the evidence in the record, which the Court deemed as showing that SCJ performed services which independent jobbers did not ordinarily provide for themselves, the Court stated (309 F.2d at 219) :

It is true that the evidence reviewed above may not establish with sufficient precision to warrant a finding to that effect, that such cost savings to the manufacturers were equal to the discount allowed. But since it is established in the evidence that there were these differences in the methods by which manufacturers sold to jobber-members, as compared to independent jobbers, the burden was on the Commission to show that the cost saving could not be commensurate with the price differential.

Accordingly, the Court remanded the case to the Commission for decision of the question of "cost justification", and also directed that "the issue of the status of SCJ as the buyer and direct recipient of the price differential should be further considered." 309 F.2d at 221. Although this Court mentioned petitioners' contention that Section 4 of the Robinson-Patman Act exempted a buying group organized as a cooperative from proceedings under Section 2(f), it did not resolve this issue.

#### **Proceedings after remand**

The Commission reopened the proceedings and further hearings were held before a new hearing examiner who, on November 11, 1964, filed his initial decision. Although the examiner was of the opinion that the members of SCJ were the purchasers



from their suppliers, he ruled that counsel supporting the complaint, in proposed findings filed with him, had conceded that the discounts received by independent "warehouse distributors" were cost justified (Initial Decision, p. 28).<sup>4</sup> In this respect, he found that SCJ performed functions similar to those performed by warehouse distributors, and reasoned that the same discounts received by petitioners were also cost justified (Initial Decision, p. 34).

Counsel supporting the complaint appealed from this decision to the Commission, claiming that the initial decision was based on an erroneous interpretation of their proposed findings, *i.e.*, that they had not conceded that warehouse distributor discounts were "cost justified" within the meaning of the Act. On December 17, 1965, the Commission vacated the initial decision and issued its own findings, opinion, and order. The Commission, finding that SCJ functioned as a buying agent for its members, held that the jobber-members should be deemed "purchasers" from their suppliers (Comm. Findings, p. 15; Comm. Opinion, 7-8). It found that the evidence clearly established that the 20 percent average discount received by SCJ and passed on in substantial part to its members could not be justified as saving suppliers

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<sup>4</sup> In this brief, references are to the original pages of the initial decision and Commission's findings and opinion as printed in Exhibits A and B attached to the petition for review. "Tr" refers to the pages of transcript of testimony contained in the certified transcript of record; "CX" refers to the Commission's exhibits and "RX" to the petitioners' exhibits.

that amount in costs in selling to petitioners as compared to selling to direct buying jobbers, and that petitioners should have been so aware (Comm. Findings, pp. 8-9, 26-28). It held that the hearing examiner had not given adequate consideration to the evidence on this issue and that the proposed findings which he relied upon (even construing them as he did), would not be conclusive if an independent evaluation of the record showed the contrary to be true (Comm. Opinion, p. 8).

Finding the inducement and receipt of such discounts a violation of Section 2(f) of the Clayton Act (Comm. Conclusions, p. 29), the Commission issued a cease and desist order against further receipt of such lower prices (Comm. Order, pp. 29-33).<sup>5</sup> Commissioners Elman and Jones dissented, filing their own opinions (see Exhibit B, Petition for review).

### The facts

The facts are not the subject of significant dispute. They are set forth in detail in the Commission's "Findings as to the Facts, Conclusions of Law, and Order" and in its "Opinion," and may be summarized as follows.

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<sup>5</sup> The Commission provided that the order should not run against those members named in the original complaint who severed their connections with SCJ prior to the proceedings on remand (Comm. Opinion, p. 24). Accordingly, by order dated May 6, 1966 (not printed), the Commission, on motion, set aside the order as to respondents Earl Crawford, Lester L. Congdon, Margaret A. Ludwick, Otis M. Ludwick, E. L. Covey, Edward Gaughn, Carl D. Haase and Emma F. Wright.



*The structure and operation of SCJ.* SCJ is a "cooperative" incorporated under California law in 1935 and presently does business in Los Angeles, California. It has a membership of some sixty-six jobbers, who do business in Los Angeles as distributors of automotive replacement parts to garages, service stations, fleet owners, and car dealers (Comm. Findings, p. 9).

SCJ presently operates a warehouse which has approximately 37,200 square feet of space, and a truck delivery service for its employees (See Pet. Br. 5). It employs 37 people, ten of which are in its trucking division (Comm. Findings, p. 11).

The jobber-members of SCJ compete with other jobbers in their respective trade areas. These other jobbers either buy directly from manufacturers, in which case they are referred to as "direct buying jobbers," or they buy from independent "warehouse distributors".<sup>6</sup> Jobbers pay the same jobber "list

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<sup>6</sup> The record shows that the direct buying jobbers constitute a substantial part of the manufacturers' selling market in Los Angeles. One manufacturer testified that he sells to two warehouse distributors (including SCJ) and 50 direct jobbers (Tr. 1058, 1060, 1084). Another sells to seven warehouse distributors and 60 direct jobbers (Tr. 1144-46). Another, to "five or six" warehouse distributors in Southern California and about 500 direct jobbers in the same area (Tr. 1233-34, 1239). A fourth estimated that one third of his sales are to direct jobbers (Tr. 2030).

The record also shows that SCJ jobbers are generally larger, more firmly entrenched, and in a better financial position than other jobbers in their trading area (Tr. 1117, 1128, 1247-48, 1274, 1486-87, 1500-01, 1565, 1571, 1756, 1822-23, 2034-35).

price" whether they buy directly from manufacturers or from warehouse distributors. Warehouse distributors are wholesalers who generally confine their sales to jobber customers. They generally receive a 20 percent "functional discount" off the jobber "list price" from their suppliers on sales they make to jobbers (Comm. Findings, p. 8).

SCJ is classified as a warehouse distributor by the manufacturers of the seventy-odd lines of automotive parts which it carries. It receives warehouse distributor functional discounts on its purchases. After paying all operating expenses, which usually amount to approximately six percent, SCJ passes on the remaining balance of the discounts to the jobber-members in the form of patronage refunds. In 1963, the average refund exceeded 15 percent (Comm. Findings, pp. 12-13).

It is the difference between the price to SCJ and the price to the "direct jobbers" that is the subject of this proceeding (Comm. Findings, p. 11).

As stated in its articles of incorporation, it is the purpose of SCJ to provide a "joint buying and pickup service" for the jobber-members in order that such members may buy the articles used in their business for better mutual advantage. The bylaws provide that the affairs of SCJ be conducted by a board of directors of seven members elected by the stockholders for a term of two years. The board of directors is charged with the duty of appointing, supervising, removing at its discretion, and prescribing the duties of the officers, agents, and employees of SCJ. The determination of which automotive parts

lines are to be carried by SCJ is made by the board of directors after recommendation by the organization's merchandising committee consisting of four to eight members who interview representatives desiring to sell their lines. Before deciding whether to take on a particular line, the board of directors generally canvasses the members to determine whether they will support the line (Comm. Findings, pp. 10-11).

Under the bylaws, the acceptance of new members is subject to the approval of the board of directors, based upon the recommendation of a membership committee. As of 1956 and in prior years it was the policy of SCJ to accept applications only from jobbers located in territories not covered by the present membership. There is some evidence indicating that as of the time of the hearings on remand there were a number of members competing with other SCJ members in their territory. SCJ does no business with any jobber who is not a member (Comm. Findings, p. 10).

The Commission found the financial requirements for membership to be substantial, having increased from \$4,450 at the time of the original hearings to \$9,000 at the time of hearings on remand (Comm. Findings, p. 9).

The discounts received by SCJ from manufacturers are "impounded" by SCJ pursuant to its bylaws, which provide that the such discounts "shall be and remain the property of the stockholders of said corporation and at no time shall become the

property of the corporation itself." These impounds are periodically credited to members' accounts and each member shares proportionately the expenses incurred in the operation of SCJ (Comm. Findings, p. 12).

In 1963 purchases by petitioners *via* SCJ were approximately \$3,500,000. Total rebates to members, after deduction of expenses, amounted to about \$686,000 in that year (Comm. Findings, p. 12).

*Manufacturers' selling and distribution costs.* The record shows that the selling effort expended by manufacturers with respect to sales to petitioners and to jobbers buying directly can be broken down into the following elements:

- (1) Compensation for sales personnel;
- (2) Freight and delivery costs;
- (3) Publication and distribution of catalogs and price lists;
- (4) Billing and credit expenses;
- (5) Warehousing costs.

1. *Compensation for sales personnel.* The Commission found that manufacturers send sales representatives on periodic calls to all jobber customers to ensure the orderly distribution of their products. Since SCJ has had no salesmen, with the limited exception noted below, the jobber-members must rely on the manufacturers' salesmen for service. On these calls the manufacturers' salesmen not only promote their merchandise but in addition perform all the necessary services for SCJ jobbers that the

manufacturers find necessary to perform for direct jobbers, such as checking inventory for imbalance and obsolescence, advising on technical problems, and checking price lists and catalogs to make sure they are up to date. Most manufacturers' representatives testified that the time spent by them in calling on SCJ jobbers is the same as in calling on direct jobbers of comparative size. The Commission noted that SCJ did not have any salesmen to call on its members to perform the tasks normally performed by manufacturers' representatives until 1964, more than a year after this proceeding was reopened by the Commission. At that time SCJ hired one salesman on a trial basis. Accordingly, the Commission found there had been no substantial difference in the manner in which these manufacturers' sales personnel contacted and serviced petitioners and direct buying jobbers. (Comm. Findings, pp. 15-17; Comm. Opinion, pp. 9-11).

2. *Freight and delivery costs.* Most manufacturers sell to their direct customers f. o. b. their factory or warehouse, granting prepayment of freight on orders in excess of a certain weight or dollar amount. In those instances where direct buying jobbers and petitioners both purchase directly from the factory, there is no difference in freight expense assuming both buy in the same quantities. In many instances, delivery expense is actually higher in selling to petitioners because petitioners buy in larger quantities and are more apt to buy in the quantities qualifying for the manufacturers' prepayment of freight



charges (Comm. Findings, p. 18, Comm. Opinion, p. 11).

Where petitioners pick up merchandise from the supplier's local warehousing facilities, there is usually no difference in delivery costs to the manufacturer, since direct buying jobbers who are also in the proximity of the suppliers' local warehouse generally pick up their requirements at the local warehouse. As for jobbers who do not generally pick up their orders, there would be little cost savings since the jobbers do not as frequently buy in quantities to qualify for prepayment of freight and therefore must pay the delivery charges themselves (Comm. Findings, pp. 18-19; Comm. Opinion, p. 11).

SCJ's fleet of trucks which distributes merchandise from the SCJ warehouse to the jobber-members does not save the manufacturers money since this is not a service the manufacturers perform for any of their customers (Comm. Findings, p. 19).

3. *Catalog expenses.* Manufacturers do not save costs in the distribution of catalogs and price sheets in selling to SCJ as compared with selling to direct buying jobbers. The expense of printing and distributing such items is borne by the manufacturer in both cases (Comm. Findings, p. 20).

4. *Billing and credit.* The Commission found that the items of centralized billing and credit are relatively unimportant items in terms of cost to the manufacturer, having no significant bearing on the question of whether redistribution discounts of the magnitude granted petitioners are cost justified *vis à vis* direct buying jobbers (Comm. Findings, p. 20).

5. *Warehousing costs.* The Commission found that the only function performed by SCJ which could possibly afford a significant saving to manufacturers is its warehousing operation. Certain of petitioners' suppliers maintain local warehousing facilities in the Los Angeles area, either their own or in the form of space in a commercial fee warehouse. SCJ's warehousing of auto parts would save the manufacturers storage costs in those instances where petitioners did not take delivery from the manufacturers' local warehouse but ordered direct from the factory. Since the fees of commercial warehouses in the Los Angeles area range in the neighborhood of 5 to 6 percent of the sale price, the Commission found that the maximum saving here would not exceed those figures (Comm. Findings, p. 20; Comm. Opinion, p. 17).

In practice, however, it is the policy of SCJ to take delivery from local warehouses since this enables SCJ to replenish its stock weekly or daily if necessary. Consequently, any savings in warehousing costs for a manufacturer is minimized by an unusually rapid turnover of inventory in SCJ's warehouse (Comm. Findings, p. 21). The Commission found it unnecessary to decide whether in these circumstances SCJ can claim that its warehousing operation results in savings within the meaning of the cost justification proviso, since the record shows that in any event petitioners warehousing operation would not exceed 5 or 6 percent (Comm. Opinion, pp. 12-13).

The Commission found the record not clear as to the extent to which manufacturers' local warehouses

break bulk and repack merchandise for customers. This question, the Commission held, was immaterial since the direct buying jobbers purchasing from a supplier's local warehouse, like SCJ, will also be buying in case lots if that is the policy of the warehouse. The fact that SCJ may subsequently break bulk will not make those transactions less costly to the supplier than on the supplier's sale to direct jobbers (Comm. Findings, p. 20).

The Commission also found that petitioners knew they were receiving substantial discounts that were unavailable to direct buying jobbers. The jobber-members of SCJ who served on its merchandising and warehousing committee became acquainted with the operations of the suppliers and the manner in which the group was to be served. Moreover, the jobber-members of SCJ were well acquainted with the buying group's operation. They knew from their own experience the amount of sales and distributional effort expended on them by various of their suppliers as compared to the effort expended on direct buying jobbers; certain of SCJ's members were direct buying jobbers before the suppliers commenced granting SCJ a functional discount (Comm. Findings, pp. 26-28, Comm. Opinion, pp. 15-16).

The Commission concluded from the foregoing facts and the trade experience of petitioners generally, that they knew or should have known that their suppliers were expending approximately the same effort on them as on jobbers purchasing directly and that, in any case, the price differentials



of the size shown by the record could not be justified as reflecting comparable cost savings (Comm. Findings, pp. 26-28).

### SUMMARY OF ARGUMENT

The jobber-members of SCJ have absolute ownership and control over the substantial discounts granted SCJ by suppliers; SCJ is merely the jobber-members' purchasing agent. Therefore, the jobber-members are the real purchasers under the Act.

The fact that petitioners do business through a cooperative does not exempt their receipt of substantial discounts from the application of Section 2(f) of the Clayton Act. The legislative history and cases construing Section 4 of the Robinson-Patman Act show that the exemption there stated was for a limited purpose, *i.e.*, to insure that patronage rebates by cooperatives to members would not be considered "price discriminations" simply because they are proportioned according to the volume of purchases from or through the cooperative. It also appears that Section 4 was really intended for consumer and producer cooperatives and not for wholesale cooperatives.

It is not disputed that the discriminatory prices afforded petitioners may have the effect upon competition between the jobber-members of SCJ and the direct buying jobbers proscribed by Section 2(a).

Insofar as most manufacturers are concerned, the costs of selling to petitioners as compared to selling to such direct buying jobbers are virtually identical. With some manufacturers the savings might reach

five or six percent, but no more. Petitioners' argument that the 20 percent price differential is "cost justified" is based on the erroneous assumption that the functional discounts received by independent warehouse distributors are cost justified within the meaning of the Act and that the issue becomes one of comparing the warehouse functions performed by SCJ with those of the independent warehouse distributors. To the contrary, there is no reason to believe that the functional discounts received by the warehouse distributors are in fact cost justified under the Act. The only test to be applied in this case is whether the discounts granted petitioners "make only due allowances, for differences in the cost of manufacturing, sale or delivery resulting from differing methods or quantities in which such commodities" are sold to petitioners and direct buying jobbers. Accordingly, the suppliers' costs of selling to independent warehouse distributors are completely irrelevant in this case.

The record supports the Commission's finding that petitioners knew or had reason to know that the lower prices they induced and received were not cost justified.

There is no substance to petitioners' charge that the Commission's decision in this case will have the effect of putting SCJ and all other cooperatives out of business. The Commission does not challenge the operation of a cooperative warehousing enterprise provided it is not used in a manner which results in violation of the Clayton Act. The order does not prevent SCJ from receiving lower prices that reflect

actual differences in selling and delivery costs to manufacturers.

## ARGUMENT

### Preliminary statement

At the outset it should be emphasized that the one single idea that has caused most of the misunderstanding, and, accordingly, the differences of opinion in the circumstances of this case is that the "functional discounts" granted to warehouse distributors are sanctioned by Section 2(a) of the Clayton Act. Nothing could be further from the fact. Functional discounts are not sanctioned as such. *Forster Mfg. Co. v. Federal Trade Commission*, 335 F.2d 47, 53 (1st Cir. 1964), *cert. denied*, 380 U.S. 906, *order affirmed after remand to the Commission*, 361 F.2d 340 (1st Cir. 1966); *Mueller Co. v. Federal Trade Commission*, 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923; *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37, 44 (1948).

Accordingly, when a manufacturer establishes a two price system, *e.g.*, a jobber price and a lower warehouse distributor price, the resulting price difference is a discrimination in price within the meaning of Section 2(a) of the Act. *Federal Trade Commission v. Anheuser-Busch, Inc.*, 363 U.S. 536, 549 (1960); *Tri-Valley Packing Ass'n. v. Federal Trade Commission*, 329 F.2d 694, 697-98 (9th Cir. 1964). If that price discrimination may have the proscribed effect upon competition and it is not otherwise permitted by one of the statutory defenses, *e.g.*, "cost justification" or "good faith" meeting of competition, it is unlawful. Usually the price differentials

resulting from such functional discounts are lawful because there is no competition in the resale of the suppliers' products between the favored and nonfavored purchasers, and therefore no adverse ~~af~~-fect upon competition in the resale of such products is anticipated. Moreover, where the warehouse distributor resells the suppliers' products to jobbers at substantially the same price as the suppliers sell directly to jobbers, no adverse ~~af~~-fect upon competition "with customers of either of them" is anticipated.<sup>7</sup> Significantly, functional discounts are not usually premised on cost savings cognizable under the "cost justification" proviso of Section 2(a).<sup>8</sup>

The fact that a price discrimination afforded one warehouse distributor customer through a functional discount does not violate Section 2(a), does not automatically mean that affording the same discount to all warehouse distributors is legal. Each price discrimination must be tested on its own merits with respect to the statutory requirements. The statute clearly places emphasis on individual competitive situations in measuring the competitive effect of the price discriminations as well as any "cost justification" of such pricing. See *Federal Trade Commis-*

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<sup>7</sup> Section 2(a) of the Clayton Act, as amended, Appendix A, *infra*, p. 1a. See *Standard Oil Co. v. Federal Trade Commission*, 173 F.2d 210, 212, 217 (7th Cir. 1949), *reversed on other grounds*, 340 U.S. 231 (1951). The court held that a seller is in violation of Section 2(a) if he sells to retailers at one price and wholesalers at a lower price with knowledge that the wholesalers are selling to their customers at a price low enough to result in injury to competition on the retail level.

<sup>8</sup> See n. 35, *infra* at p. 45.

sion v. *Sun Oil Co.*, 371 U.S. 505 (1963); *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37, 46-47, 49-51 (1948).

In the instant case the legality of the 20 percent warehouse distributor's functional discount is measured by the fact that when granted to the independent warehouse distributors other than SCJ the resulting price discrimination would not cause any adverse effect upon competition. These independent warehouse distributors do not compete with direct buying jobbers in the resale of the supplier's products to dealers and the price at which they resell such products to their jobber customers is the same price at which the suppliers sell to direct buying jobbers.<sup>9</sup> The legality of the discriminations afforded these independent warehouse distributors is not dependent upon the "cost justification" proviso.

On the other hand, an analysis of the SCJ operation shows that the 20 percent discrimination in price that it receives, as compared to the higher price paid by the direct buying jobbers, may have the proscribed effect upon competition in the resale of the suppliers' products. For not only are the jobber-members the recipients of the so-called functional

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<sup>9</sup> In their brief (p. 14) petitioners assert that some of the independent warehouse distributors do operate jobber outlets. Of course, as with SCJ, that portion of their operation which results in competition in the resale of products to dealers would be subject to challenge under Sections 2(a) or 2(f) of the Clayton Act. See *Monroe Auto Equipment Co. v. Federal Trade Commission*, 347 F.2d 401 (7th Cir. 1965), *cert. denied*, 382 U.S. 1009 (1966); see *infra*, p. 30.



discount, in that SCJ is merely their purchasing agent, but these jobber-members actually retain about 15 percent of this differential in rebates, it costing only 5 to 6 percent to operate the SCJ warehouse. Moreover, as the Commission found, the difference in the cost to the suppliers in selling to petitioners as compared to the direct buying jobbers did not "cost justify" this 20 percent differential in price.

Petitioners have never disputed the Commission's finding that the price discriminations which they received and induced from their suppliers may have the proscribed effect upon competition within the meaning of Section 2(a).<sup>10</sup> In the absence of a showing to the contrary, the Commission's findings should be accepted as final. See *Steelco Stainless Steel, Inc. v. Federal Trade Commission*, 187 F.2d 693, 695 (7th Cir. 1951); *Keele Hair & Scalp Specialists, Inc. v. Federal Trade Commission*, 275 F.2d 18, 21 (5th Cir. 1960).

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<sup>10</sup> In his dissenting opinion (pp. 3, 13-20), Commissioner Elman takes the position that there is no injury to competition between the SCJ jobber-members and direct buying jobbers. This position, however, is contrary to the holdings in the many automotive parts cases previously decided by the Commission and affirmed by the courts of appeals, and reflects a view not taken by petitioners on this appeal. The fact that the SCJ jobbers resell to dealers at the same price that direct buying jobbers resell to dealers is not controlling. "Sales are not the sole indicium that reflect the health of the competitive scene." *E. Edelmann & Co. v. Federal Trade Commission*, 239 F.2d 152, 154 (7th Cir. 1956), *cert. denied*, 355 U.S. 941.

In the following sections of this brief we shall treat in detail the questions of law raised in petitioners' brief and the further questions as to whether there is substantial evidence considering the record as a whole to support the Commission's findings that the jobber members of SCJ were the "purchasers" within the meaning of the Act, and that the challenged price discriminations were not "cost justified" and that petitioners were so aware. *Universal Camera Corp. v. National Labor Relations Board*, 340 U.S. 474, 487-488 (1951); *Fred Meyer, Inc. v. Federal Trade Commission*, 359 F.2d 351, 357 (9th Cir. 1966).<sup>11</sup>

- I. There is substantial evidence to support the Commission's finding that the jobber-members of SCJ are the "purchasers" from the suppliers within the meaning of Section 2(a) of the Clayton Act.

In remanding this case to the Commission, the Court called for further "analysis, findings and conclusions" as to whether the jobber-members of SCJ are the "purchasers" of automotive parts from manufacturers within the meaning of Section 2(a) of the Robinson-Patman Act, which provides that "\* \* \* it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and

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<sup>11</sup> Section 11(c) of the Clayton Act provides that "the findings of the commission . . . as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. 21(c). See also Section 10(e), Administrative Procedure Act, 5 U.S.C. 1009(e).

quality \* \* \*” 309 F.2d at 219-221. In its opinion on remand, the Commission stated (Comm. Opinion, p. 5) that, in its view, the applicable principles governing the determination of this issue had recently been set forth in its decision in *National Parts Warehouse, et al*, FTC Docket No. 8039 (1963), *aff'd. sub nom, General Auto Supplies, Inc. v. Federal Trade Commission*, 346 F.2d 311 (7th Cir. 1965).<sup>12</sup> The Commission summarized its holding in that case as follows:

If the buying group acts as the agent of its members in the challenged transactions, then as to those purchasers the buyer-seller relationship is necessarily established between the jobber respondents and their suppliers (Comm. Opinion, p. 5).

On the basis of the record facts in this case, the Commission found that, as in *National Parts Ware-*

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<sup>12</sup> The Commission's decision in *National Parts Warehouse* is reported at CCH Trade Reg. Rep. (1963-65 Transfer Binder) § 16,700. In that case 55 jobbers formed a limited partnership composed of the 55 jobbers as the limited partners and a general partner who was not an auto parts dealer and who managed the group's warehousing operation. Previously the jobbers had formed membership cooperatives similar to SCJ but had abandoned these forms on the advice of counsel in 1956. It was their contention that being limited partners they had no "control" over the management of the warehousing operation and did not "deal directly" with manufacturers. The Commission held that the matter of control over day to day management was beside the point, that what was important was control over the partnership's receipt of discriminatory price concessions that may have the effect on competition proscribed by the Act.



house, the group entity, which transacted business with the suppliers and which is engaged in the warehousing of goods for eventual delivery to members, was acting as the agent of its members in the challenged transactions.

Petitioners do not appear to dispute the underlying findings made by the Commission regarding the lack of autonomy in SCJ as reflected in its articles of incorporation and by-laws, its method of selecting merchandise, and in the fact that it sells only to its own members and passes on all discounts to them.<sup>13</sup> Their argument is directed solely against the Commission's conclusionary finding that the relationship amounts to one of agency and that the members of SCJ are the "purchasers" for the purposes of the Robinson-Patman Act (Pet. Br. pp. 8-17). In substance, petitioners contend that the Commission's ruling is erroneous because there are no direct sales<sup>14</sup> by the suppliers to the jobber-members, as the goods are purchased by SCJ in large quantities and placed in a warehouse from which individual jobber orders are filled. In addition, petitioners rely upon the fact that the suppliers look to SCJ, not the jobber-members, for payment (Pet. Br. pp. 8-13).

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<sup>13</sup> See Commission Findings, pp. 9-15, Commission Opinion, pp. 7-8, and *supra* pp. 9-11.

<sup>14</sup> Petitioners also say there were no "direct dealings" between the manufacturers and the jobber-members of SCJ (Pet. Br. 10). Since they concede in other parts of their brief that manufacturers and jobber-members had "direct dealings" insofar as the manufacturers devoted considerable sales representatives' time to the individual jobber-members, we understand petitioners' argument to be as indicated.

These facts, however, are not controlling. It is well settled that several principals can appoint a common agent in a joint enterprise and that such an agent can be authorized to purchase, sell, and hold goods on behalf of the principals. In most instances where courts have had occasion to examine the relationship between cooperatives and their members they have found it to be one of agency, sometimes characterizing the cooperative as holding all income and property as trustee for the members. *San Joaquin Valley Poultry Producers Assn. v. Commissioner*, 136 F.2d 382, 385 (9th Cir. 1943); *Fruit Growers' Supply Co. v. Commissioner*, 56 F.2d 90 (9th Cir. 1932).<sup>15</sup> The fact that the transfer of

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<sup>15</sup> See also *Midland Cooperative Wholesale v. Ickes*, 125 F.2d 618 (8th Cir. 1942), *cert. denied*, 316 U.S. 673, involving the question as to whether a cooperative purchasing organization was a wholesaler under the Bituminous Coal Act and therefore entitled to receive functional discounts, or whether it was an "instrumentality of a retailer" under the act (pp. 633, 635, 636):

It is the nature of petitioner's activities which disqualifies it from obtaining authorization to accept discounts from the established minimum prices. Petitioner is not like conventional wholesalers, engaging in the business of buying coal and then reselling it to such customers as it is able to find; it is not a distributive agency standing between producer and consumer and independent of both; it is a "purchasing agent" for its member associations. As such it is an "instrumentality of retailers" \* \* \* and therefore is prohibited from receiving any discounts from the established prices.

\* \* \* \*

The patronage dividend is as much a part of the transaction as the price itself. If petitioner did not distribute

goods between cooperative and member may have all the formal indicia of purchase and sale does not change the nature of the relationship. *California & Hawaiian Sugar Refining Corp. v. Commissioner*, 163 F.2d 531, 535 (9th Cir. 1947), *cert. denied*, 332 U.S. 846.

An agency relationship was found even though in many of these cases it was clear that the cooperatives were not sham devices but performed real distribution functions for their members.<sup>16</sup> It was the

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patronage dividends or hold out they would do so—as under Minnesota law and its by-laws it must—there would doubtless be no sales of coal by it. Petitioner admits this. It is its promise and obligation to pay patronage dividends on this coal business that provides the incentive for the purchase of coal from petitioner \* \* \*.

\* \* \* \*

Such practices, if permitted, would serve to give one seller an unfair advantage over others. Translated into this case it means that petitioners, owing to the distribution of patronage dividends, enjoys some competitive advantage over the conventional distributor. An advantage of this kind, it is obvious, would tend to increase the business of petitioner at the expense of its competitors \* \* \*.

See also *United States v. Mississippi Chemical Co.* 326 F.2d 569 (5th Cir. 1964); *Oliver v. United States*, 193 F. Supp. 930, 937-38 (E.D. Ark, 1961); *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201 (N.D. Iowa 1949); *Bogardus v. Santa Ana Walnut Growers Assn.*, 41 Cal. App. 2d 939, 108 P.2d 52, 57 (1941); *Irvine Co. v. McColgan*, 26 Cal. 2d 160, 157 F.2d 847, 850 (1945).

<sup>16</sup> The fact that the cooperatives in some of the cases cited may have been marketing cooperatives, rather than purchasing cooperatives as is the case here, should not detract from

element of control by the members that was decisive in these cases. Where, however, unlike the instant case, the *cooperative* possessed full discretion to grant or withhold patronage refunds from members and in fact diverted such amounts for purposes other than patronage refunds, the cooperative has not generally been regarded as the agent of the members.<sup>17</sup>

As for SCJ, its articles of incorporation state that it was brought into being to function as a "joint buying and pickup service" for the members (CX 2, p. 1). That it has continued to exist as such and that its primary purpose is to secure discounts for its members is made clear by its by-laws which provide that all discounts are "impounded" and "remain the property of the stockholders of said corporation, and at no time shall become the property of the corporation itself, but shall be held by it for the

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their value as precedents. One type of cooperative is merely the converse of the other. In marketing cooperatives the members pool their commodities for the purpose of joint selling and, many times, joint storage and processing. In the case of SCJ, each member pools his money into the Merchandise Guarantee Fund (CX 3, Article XXIII) for the purpose of joint buying and warehousing. Cf. *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 216 (N.D. Iowa 1949): "Although \* \* \* [some] cases deal with marketing cooperatives, it could be argued that the conclusions stated would hold true for purchasing cooperatives also, in view of the general language used by Courts in construing these cooperative contracts."

<sup>17</sup> *American Box Shook Export Assn. v. Commissioner*, 156 F.2d 629 (9th Cir. 1946); *Fountain City Co-operative Creamery Assn. v. Commissioner*, 172 F.2d 666 (7th Cir. 1949).

purpose of properly prorating same among the separate participating stockholders" (CX 3, p. 10).

Furthermore, the Commission made it clear that even aside from documentary evidence showing intention by the parties to create a buying agent, SCJ does in fact function as a controlled conduit for members' receipt of lower prices.<sup>18</sup> Thus it observed (Comm. Opinion, p. 7):

In short, as a practical matter the respondent corporation has no discretion over the prices it "charges" its members and the respondent jobbers by reserving to themselves the absolute right to receive SCJ profits have assumed the responsibilities of the transactions from which such profits are derived.

The fact that SCJ no longer runs a pure "brokerage" type of operation but buys, stores, and redistributes goods in much the same fashion as a warehouse distributor does not alter the result. As the

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<sup>18</sup> It is for the very reason that most cooperatives are considered agents or conduits through which income of the cooperative passes to the members that they have in the past successfully maintained that such earnings are not taxable income to the cooperative. See, *e.g.* *San Joaquin Valley Poultry Producers Assn. v. Commissioner*, 136 F.2d 382, 385 (9th Cir. 1943); followed in *United States v. Mississippi Chemical Co.*, 326 F.2d 569 (5th Cir. 1964). Since SCJ concedes it avoids paying income tax on the ground it is a cooperative, it is surprising for it to insist here that its relationship with its members is not one of agency but an ordinary vendor-vendee relationship. (See "Memorandum in Opposition to Proposed Findings," p. 7, filed by petitioners on September 15, 1964, and found in the reproduced record at R. 3753).



Commission explained in *National Parts Warehouse*:<sup>19</sup>

\* \* \* it may be true that NPW actually performs the same *warehousing* function that “other” warehouse distributors perform. But we do not see how that affects the question of whether NPW is a “purchaser” in its own right, or a mere agent of its owner jobbers. The mere ownership and operation of physical facilities cannot change an agent into a principal. It is the fact that these jobber partners of NPW own it outright, and “control” the flow of its income from the partnership coffers to their own pockets, that establishes the principal-agent relationship, and makes them responsible for its acts. The clothing of their creature with the trappings of a “warehouse distributor” does not cause the parties to cease being principal and agent, and become, instead “seller” and “buyer”.

The Commission’s findings of an agency relationship in that case was upheld by the Court of Appeals for the Seventh Circuit. *General Auto Supplies, Inc. v. Federal Trade Commission*, 346 F.2d 311, 315 (1965).

Petitioners argue that the fact that SCJ is controlled by its stockholders is not significant as every corporation is controlled by stockholders (Pet. Br. p. 10). This overlooks the critical fact that here it is not just stockholders who control, but stockholders who also are the “customers” of the corporate entity

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<sup>19</sup> CCH Trade Reg. Rep. (1963-1965 Transfer Binder) at p. 21,615, quoted in the Commission’s opinion in the instant case at p. 6.

and who control to the extent of leaving no discretion as to resale prices in the corporation and who appropriate all discounts to themselves in the form of rebates.

Consistent with the Commission's approach in this case is another recent court decision upholding the Commission's ruling in an automotive parts case where a warehouse distributorship and a jobber business were separately incorporated but under common ownership. The Commission ruled they should be treated as a single entity on transactions between themselves; that is, the warehouse distributor could not receive functional discounts on goods which it "re-sold" to an affiliated jobber outlet if such discounts could not be cost justified and were harmful or potentially harmful to competition between the jobber and his competitors. The Court upheld the Commission's finding that any lower price granted to the warehouse distributor in such circumstances would, in the light of business realities shown in the record, result in "direct benefit" to the jobber outlet. *Monroe Auto Equipment Co. v. Federal Trade Commission*, 347 F.2d 401, 403 (7th Cir. 1965), *cert. denied*, 382 U.S. 1009 (1966). See also *Purolator Products, Inc. v. Federal Trade Commission*, 352 F.2d 874 (7th Cir. 1965).<sup>20</sup> In the instant case the same "direct benefit" automatically flows to the job-

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<sup>20</sup> It should also be noted that the respondent-suppliers in these cases failed to demonstrate that the functional discounts were cost justified.



ber-members of SCJ.<sup>21</sup>

The words "purchaser" and "customer" as used in the Act have always been construed broadly so as to effectuate the "fundamental aim of the Robinson-Patman Act to protect buyers' competitors from the evil effects of *direct* or *indirect* price discrimination" *American News Co. v. Federal Trade Commission*, 300 F.2d 104, 109 (2d Cir. 1962) *cert. denied*, 371 U.S. 824 (emphasis added).<sup>23</sup> The approach in all

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<sup>21</sup> Cf. *American Cooperative Serum Assn. v. Anchor Serum Co.*, 153 F.2d 907, 914 (7th Cir. 1946), *cert. denied*, 329 U.S. 721, a price discrimination case involving a cooperative:

It is possible that Anchor never dictated to Serum Association what price it should charge its members, or the price at which those members should sell to the consumers. However, it must have known it was dealing with a cooperative which was acting as agent for the many Farm Bureaus who were its members, and that whatever Anchor paid to this cooperative in the way of rebates was in violation of the statute, and that such fund, less expenses, would eventually go to the Farm Bureaus, which in turn would be distributed to the consumers, thus in effect reducing the price which they had paid for their serum.

See also *Mennen Co. v. Federal Trade Commission*, 288 Fed. 774, 782 (2d Cir. 1923), *cert. denied*, 262 U.S. 759.

<sup>23</sup> Cf. *Securities Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943): "[C]ourts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." Only recently the Supreme Court held that, in construing the Clayton Act, "literal wording" must never be permitted to frustrate "basic policy objectives." *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.*, 381 U.S. 311, 320-21 (1965).

of these cases has been to determine in the first place whether there has been, or may be, injury to competition due to substantial price differences received by competitors on commodities originating from a common supplier. If so, and if responsibility for inducement and receipt of the lower price is attributable to the favored buyer, either individually or as a member of a group who have combined their purchasing power, then the favored buyer should be considered the "purchaser."<sup>24</sup> As implicitly recognized by the courts, any other interpretation would create a loophole that could well undermine the Act. It is well known, for example, that many large retail chains have warehousing depots to serve branch stores. Under petitioners' interpretation, such a retail chain could skirt the prohibitions of the Act by simply forming a subsidiary corporation, transferring to it all its warehousing facilities, and then obtain for it a wholesalers discount even though the resulting difference in price might not be cost justi-

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<sup>24</sup> "[W]here the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited. Like . . . the Federal Communications Commission's determination that one company is under the control of another (*Rochester Telephone Corp. v. United States*, 307 U.S. 125) the Board's determination . . . is to be accepted if it has 'warrant in the record' and a reasonable basis in law." *National Labor Relations Board v. Hearst Publications, Inc.*, 322 U.S. 111, 131 (1944) (upholding the agency's broad construction of the term "employee" beyond its technical definition at common law). See also *United States v. Drum*, 368 U.S. 370, 375-76 (1962).

fied. It is clear from the cases that such an attempted circumvention of the Act should not be tolerated. And by the same token it would be anomalous to hold that a group of jobbers could combine together and achieve the same result by simply utilizing the device of a cooperative. The fact that members of SCJ are not large retail chains does not alter the result since the Act, although primarily aimed at buying practices of retail chains, was intended to cover *all* price discriminations that are injurious to competition whether received by chains or by individuals.<sup>25</sup>

**II. The Commission properly rejected petitioners' claim that Section 4 of the Robinson-Patman Act confers immunity on their receipt of lower discriminatory prices that would otherwise be prohibited by Section 2(f) of the Act.**

In its opinion the Commission rejected petitioners' reliance upon Section 4 of the Robinson-Patman

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<sup>25</sup> "While as noted, the immediate and generating cause of the Robinson-Patman amendments may have been a congressional reaction to what were believed to be predatory uses of mass purchasing power by chain stores, neither the scope nor the intent of the statute was limited to that precise situation or set of circumstances. Congress sought generally to obviate price discrimination practices threatening independent merchants and businessmen presumably from whatever sources . . . In short, Congress intended to assure, to the extent reasonably practicable, that businessmen at the same functional level would start on equal competitive footing so far as price is concerned." *Federal Trade Commission v. Sun Oil Co.*, 371 U.S. 505, 520 (1963).

Act.<sup>26</sup> The Commission stated (Comm. Opinion, pp. 23-24) :

\* \* \* The Commission does not seek to prevent the distribution of earnings by cooperatives as authorized by that statute. But the statutory exemption extends only to the distribution of such earnings which are the fruits of lawful activity. The statute does not, as [petitioners'] argument implies, confer upon organizations such as those of [petitioners] blanket exemption from the Robinson-Patman Act nor "does [it] permit a cooperative to violate Section 2(f) even though its savings through receipt of discriminatory prices are passed on to its members."<sup>27</sup>

Asserting that the illegal conduct charged in this case arises only when "SCJ grants a credit to its customers at the quarter's end" (Br. 36), and that, accordingly, "the distribution of profits is the one indispensable element of the alleged offense" (Br. 37), petitioners argue that the Commission, in effect, would prohibit conduct that Section 4 permits and that, as construed by the Commission, Section 4 "has no meaning at all."

Petitioners have completely misconstrued the stat-

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<sup>26</sup> "Sec. 4. \* \* \* Nothing in this act shall prevent a cooperative association from returning to its members, producers, or consumers the whole, or any part of, the net earnings of surplus resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association" (49 Stat. 1528, 15 U.S.C. 13b).

<sup>27</sup> Commission's footnote: "*American Motor Specialties Co., Inc., et al v. Federal Trade Commission*, 278 F.2d 225, 229 (2d Cir. 1960), *cert. denied*, 364 U.S. 884 (1960)."

utory language and purpose of Section 4.<sup>28</sup> Examination of the legislative history of Section 4, as well as the cases that have construed that section, plainly shows that the Commission's rejection of Section 4 as a defense to the Section 2(f) violation found was proper in all respects.

Petitioners are mistaken in asserting: "The discounts granted to SCJ are the same as those given to all warehouse distributors. So there is no discrimination at this point" (Br. 36). As we have heretofore pointed out (*supra* pp. 9, 20) the discriminations challenged in this proceeding arise from the prices charged SCJ and its member stockholders as compared to the prices charged direct buying jobbers. The prices charged the independ-

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<sup>28</sup> Although the Supreme Court has never ruled on the scope of Section 4, it has recently had occasion to reemphasize the long-standing rule that "immunity from the antitrust laws is not lightly implied." *United States v. Philadelphia National Bank*, 374 U.S. 321, 348 (1963); *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963). As to cooperatives in particular, the Supreme Court has ruled that even though state legislatures and Congress have often enacted legislation encouraging the existence of such entities, exemptory language in antitrust statutes is to be strictly construed. *Maryland and Virginia Milk Producers Association v. United States*, 362 U.S. 458, 464-466 (1960); *United States v. Borden Co.*, 308 U.S. 188, 198, 201 (1939). See also *Associated Press v. United States*, 326 U.S. 1, 14, 19 (1945), where the Court, in denying that actions by or through a cooperative places the members beyond the pale of the Sherman Act, stated: "It is significant that when Congress has desired to permit cooperatives to interfere with the competitive system of business, it has done so expressly by legislation" and "to stifle competition cannot be immunized by adopting a membership device accomplishing that purpose."



ent warehouse distributors are not involved. Moreover, if, as the Commission found, the stockholder members of SCJ are the "purchasers," the lower prices are actually paid to them irrespective of the method in which they have paid the cooperative's bills and have distributed the surplus to themselves.

It is the *method* of distributing profits that Section 4 exempts, not the *fact* that the member stockholders induced and received the price discriminations. Once it is established that the discrimination in price may have the effect upon competition proscribed by statute, a fact not disputed in this case, the discriminations giving rise to such adverse competitive effect are subject to the provisions of Sections 2(a) and 2(f) irrespective of the form of business organization under which the buyers may operate. The fact that the organization operates a warehouse does not change the application of the statute in this respect, although to the extent that such an operation actually results in a difference in cost to the suppliers selling to SCJ as compared to the direct buying jobbers, receipt of a commensurately lower price would be permitted.

To the contrary of petitioners' construction of Section 4, the legislative history shows that Congress inserted the provision not for the purpose of immunizing any discriminatory price granted to a cooperative but for the sole and limited purpose of foreclosing any possible contention that refunds are "price discriminations" among members solely because they are based on the amount of business done

with the cooperative.<sup>29</sup> Congress recognized that the rest of the bill contained “no provisions, express or implied, to the contrary” but nevertheless inserted the provision as a “precautionary” measure. The Conference Committee report on Section 4 states (H.R. Rep. No. 2951, 74th Cong., 2d Sess. 9 (1936)):

Substantially this same provision is found in the House bill as subsection (g), and in the Sen-

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<sup>29</sup> Such complaints were not unknown. See, *e.g.*, *Mooney v. Farmers' Mercantile & Elevator Co.*, 138 Minn. 199, 164 N.W. 804 (1917), where the member sued the cooperative, contending that distribution of surplus based on patronage, rather than on membership shares, was discriminatory.

It must also be recalled that by 1936, when the Act was passed, the practice of giving selected customers “rebates” was considered a devious form of price discrimination. Since many cooperatives do business with both members and non-members, granting rebates only to members, it has been held that Congress inserted Section 4 to protect cooperatives from the charge that in granting patronage only to members they are discriminating in price against non-member patrons within the meaning of Section 2(a). *Kentucky Rural Electric Cooperative Corp. v. Moloney Electric Co.*, 282 F.2d 481, 484-485 (6th Cir. 1960), *cert. denied*, 365 U.S. 812:

We agree that it was the purpose of Section 4 to protect co-operatives in their competition with corporate competitors. But this protection was specifically limited to the provision that a cooperative would not be in violation of the Act merely because of its structure as a co-operative with the distribution of its co-operative earnings among its members on a patronage basis. Under Section 4 such a distribution does not in and of itself constitute a violation of the Act, even though the act of returning profits to its members might technically be considered as constituting a discriminatory rebate or price discrimination in favor of its member purchasers and against its non-member purchasers. But that is as far as the exemption goes.



ate amendment as a part of subsection (h). However, the words "or a cooperative wholesale association from returning to its constituent retail members", which appeared following the word "consumers" in the Senate amendment, have been eliminated.<sup>[30]</sup> As so modified, this section serves to safeguard producer and consumer cooperatives against any charge of violation of the act based on their distribution of earnings or surplus among their members on a patronage basis. While the bill contains elsewhere no provisions, express or implied, to the contrary, this section is included as a precautionary reservation to protect and encourage the cooperative movement. Whether functioning as buyers or sellers, cooperatives also share under the bill the guaranties of equal treatment and equal opportunity which it seeks to accord to trade and commerce generally.

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<sup>30</sup> As indicated by the report, the Senate version had provided: "Nothing in this subsection shall prevent a cooperative association from returning to producers or consumers, *or a cooperative wholesale association from returning to its constituent retail members*, the whole, or any part of, the net surplus resulting from its trading operations in proportion to purchases from, or sales to, the association." The deletion of the italicized portion by the Conference Committee creates the clear inference that cooperative wholesale associations were not even included under this section. Rather, as the above report indicates, Section 4 as so modified applies only to "producer" and "consumer" cooperatives. There are well-recognized distinctions between "consumer" and "producer" cooperatives which are composed of ultimate producers and consumers, and "wholesale" cooperatives which are composed of retail dealers. See Packel, *The Law of Cooperatives* 17-19 (3rd ed. 1956) and Roy, *Cooperatives: Today and Tomorrow* chapters 7 and 8 (1964).

Thus petitioners' argument that unless Section 4 provides the exemption they claim in this case "it has no meaning at all" (Pet. br. p. 37) <sup>31</sup> overlooks clear legislative history and the fact that it is not unusual for Congress to insert a proviso that merely clarifies what might have been obvious without the proviso. In *Maryland and Virginia Milk Producers Assn. v. United States*, 362 U.S. 458 (1960), an argument quite similar to that put forward by petitioners was rejected by the Supreme Court. There the court below had ruled that Section 6 of the Clayton Act (which provides that "nothing contained in the antitrust laws shall be construed to forbid the existence and operation" of certain types of cooperatives) permitted such cooperatives to engage in practices that would otherwise violate Section 2 of the Sherman Act. The court below reasoned: "To say that it [the proviso] should extend only to reasonable restraints [by cooperatives] would be fallacious because no legislation was necessary to permit reasonable restraints of trade." *United States v. Maryland and Virginia Milk Producers Assn.*, 167 F. Supp. 45, 51 (D.D.C. 1950). The Supreme Court reversed, however, relying on legislative history which indicated that the proviso simply

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<sup>31</sup> Commissioner Elman also said that Section 4 must have this meaning (dissenting op. p. 12). He relied on a statement by Rowe in his book *Price Discrimination Under the Robinson-Patman Act* (1962) to the effect that the legislative history of Section 4 is equivocal as to whether cooperatives were granted exemption under that section. Inexplicably, Rowe makes no mention of the above explanation carefully set forth in the Conference Committee report.

allowed farmers to combine together as a cooperative without their association *inter se* being held an illegal combination under the Sherman Act. “[T]he section cannot support the contention that it gave such an entity full freedom to engage in predatory trade practices at will.” 362 U.S. at 465-66.<sup>32</sup>

Furthermore, the legislative history of Section 4 makes it clear that any price differential received by competitors *via* a cooperative must represent real savings to the supplier. In reporting the Conference Committee’s actions to the House, Representative Utterback, the House manager of the bill, explained (80 Cong. Rec. 9419):

Section 4 represents another provision added to the bill in the fullness of caution to protect the distribution of cooperative earnings or surplus among their members on a patronage basis. In the dealings of cooperatives with others, they share of course, the protections and guaranties of the bill as to equal treatment and equal opportunity which it extends to producers, manufacturers, and merchants in trade and commerce generally. *It leaves the members of*

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<sup>32</sup> See also *Kentucky Rural Electrification Cooperative Corp. v. Moloney Electric Co.*, 282 F.2d 481, 485 (6th Cir. 1960) citing the reasoning of the Supreme Court in the *Maryland and Virginia Milk Producers* case and observing:

If Congress intended to exempt cooperatives from the various anti-trust and price discrimination provisions of the Act, it could have easily have said so. It did not do so. Section 4 deals only with the single act of a cooperative returning its profits to its members. It does not exempt a cooperative in the acquisition of such profits in its business operations before they are distributed.

*cooperatives free to seek through cooperative endeavor the economies and savings of mass operations and, assures to them, as compared with their large corporate competitors, any real economies and savings to which those mass operations entitle them, and which they often now do not receive. There is nothing in the last section of the bill that distinguishes cooperatives, either favorably or unfavorably, from other agencies in the streams of production and trade, so far as concerns their dealings with others. [Emphasis added].*

Additional support for this view is found in statements by Representative Patman, during the extensive hearings on his bill, that wholesale grocery cooperatives were equally subject to the bill as the chain stores since they too could take advantage of mass buying and thereby threaten independent merchants. Pertinent excerpts from the hearings are included in Appendix B to this brief, *infra* pp. 4a-7a.

The members of the vast majority of the cooperatives in this country are either ultimate producers or ultimate consumers who do not compete in the *resale* of goods. Therefore injury to competition in the resale of goods never occurs by virtue of these cooperatives doing business. But where members of the cooperative are jobbers competing with non-member jobbers buying from the same supplier, Section 4 "does not turn the entity loose to acquire on behalf of its members, through the guise of group purchasing, price differentials \* \* \*." *Mid-South Distributors v. Federal Trade Commission*, 287 F.2d.

512, 516 (5th Cir. 1961), *cert. denied*, 368 U.S. 838. See also *American Motor Specialties Co. v. Federal Trade Commission*, 278 F.2d. 225, 229 (2d Cir. 1960), *cert. denied*, 364 U.S. 884.

**III. There is substantial evidence to support the Commission's findings that the price discriminations petitioners induced and received from their suppliers were not "cost justified" within the meaning of Section 2(a) of the Clayton Act, and that petitioners were so aware.**

The Commission found that petitioners' suppliers had discriminated in price by selling to petitioners at a lower price than to direct buying jobbers, and that such discriminations may have the effect upon competition proscribed by Section 2(a) of the Clayton Act. The Commission further found that there was no substantial difference in the methods in which these suppliers sold or delivered products to petitioners and to direct buying jobbers; that, accordingly, the price discriminations were not "cost justified" within the meaning of Section 2(a); and that SCJ and its stockholder jobbers knew, or should have known, that the warehouse distributor discount that they induced and received from these suppliers could not be justified as reflecting lower costs to the suppliers on sales to them than on sales to direct buying jobbers (Comm. Findings at p. 28).

Petitioners do not challenge the Commission's findings as to the amount of the discriminations received by them as compared to the direct buying jobbers, nor do they challenge the findings that such discriminations may have the proscribed effect upon competition. Petitioners' principal contention ap-



pears to be that the Commission's finding that the price discriminations were not "cost justified" is not supported by substantial evidence. In this respect, petitioners argue that because SCJ performed the same functions as warehouse distributors, they were entitled to receive the same discount as the warehouse distributors (Pet. Br. p. 18).

We submit that petitioners' argument completely ignores the requirements of Section 2(a) of the Clayton Act. Under that section a manufacturer is prohibited from selling to different customers at different prices if such a discrimination may have the effect proscribed by the statute, unless such price differences "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

In the first place, as we pointed out in our preliminary statement, Section 2(a) does not sanction functional discounts as such. *Forster Mfg. Co. v. Federal Trade Commission*, 335 F.2d 47, 53 (1st Cir. 1964), *cert. denied*, 380 U.S. 906, *order affirmed after remand*, 361 F.2d 340 (1st Cir. 1966); *Mueller Co. v. Federal Trade Commission*, 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923; *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37, 44 (1948). And the prohibitions of the statute are not limited to discriminations between customers reselling at the same level of distribution. *Standard Oil Co. v. Federal Trade Commission*, 173 F.2d 210, 212, 217 (7th Cir. 1949), *reversed on other grounds*, 340

U.S. 231 (1951). It was held in *Standard Oil* that a supplier who sets up a two-level pricing system, with the lower price going to wholesalers and the higher price to retailers, is in violation of Section 2(a) if the supplier knows that the wholesaler is passing on a substantial part of his lower price to his retailer customers resulting in the proscribed effect on competition at the retail level.<sup>33</sup> See also *Tri-Valley Packing Assn. v. Federal Trade Commission*, 329 F.2d 694, 697-98 (9th Cir. 1964).

Although discriminations in price exist by virtue of functional discounts, where the benefit of that discrimination is not passed on to the warehouse distributors' jobber customers no injury could result at the jobber level of distribution.<sup>34</sup> Accordingly, the legality of the functional discounts received by warehouse distributors depends upon the absence of a probability of injury to competition; the legality of the functional discounts is not usually premised on cost savings cognizable under the "cost justification" proviso.<sup>35</sup>

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<sup>33</sup> Section 2(a) provides that it shall be unlawful to discriminate in price "either directly or indirectly" where it may injure competition with any person "who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them" (emphasis added).

<sup>34</sup> It is undisputed that here "the warehouse distributors in the Los Angeles area expended approximately 17 to 18½ percent of the functional redistribution discount received by them in distributing automotive parts to their jobber customers" (Comm. opinion, p. 2).

<sup>35</sup> As Commissioner Elman stated (dissenting opinion p. 10): "It is very likely \* \* \* that the functional discount wheth-



It was alleged in the complaint in this case, and the Commission found, that the jobber-members of SCJ were the "purchasers" from the suppliers and that, in fact, these jobbers induced and received the challenged functional discounts. Accordingly, under the theory of the case as it was tried and decided, a discrimination between customers at different levels of distribution is not directly involved. We respectfully submit, however, that even if SCJ is considered the "purchaser," such a fact would not preclude the Commission from finding that the price discriminations are illegal under Section 2(a) by applying either the "Standard Oil" approach, *supra*, or the so-called "indirect purchaser" doctrine. See *National Parts Warehouse, supra*, CCH Trade Reg. Rep. (1963-1965 Transfer Binder) at p. 21,612-13. Where the proscribed effect upon competition results from the price discriminations, and if no cost justification can be demonstrated, a violation of the Act can be made out irrespective of the theory used to identify the "purchaser" within the meaning of Section 2(a).<sup>36</sup> Cf. *Tri-Valley Packing Assn. v. Federal Trade Commission*, 329 F.2d 694, 698 (9th Cir. 1964).

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er paid independent warehouse distributors or SCJ will be, or could be, cost justified."

Students of the auto parts industry tell us that cost justification is not the reason that a manufacturer grants functional discounts. See Davisson, *The Marketing of Automotive Parts* 918 (1954); Sawyer, *Business Aspects of Pricing Under the Robinson-Patman Act* 474-82 (1963); Taggart, *Cost Justification* 112 (1959); Fleming, "Group Buying Under the Robinson-Patman Act: The Automotive Parts Cases" 7 Buffalo L. Rev. 231, 248 (1958).

<sup>36</sup> In its first opinion in this case, *Alabama Motor Parts v. Federal Trade Commission*, 309 F.2d 213 (1962), this Court

The second point we wish to emphasize is that the "cost justification" defense is limited to the actual differences in the cost to the suppliers of selling to the customers receiving the favored treatment as compared to the customers receiving the non-favored treatment. The discriminations challenged in this case arise from the 20 percent discount afforded SCJ and its jobber-members by their suppliers, a discount which was not afforded the suppliers' direct buying jobbers. Any "cost justification" for this discrimination must necessarily relate to the difference in costs in selling to these customers. As detailed herein (pp. 11-16, 47-51), the record clearly shows, and the Commission properly found, that the suppliers treated SCJ and its jobber-members substantially the same as the suppliers treated their direct buying jobbers as to direct selling, catalog distribution, and warehousing. No substantial cost differences were involved; no "cost justification" was possible.

The costs of a supplier selling directly to the jobber customers of the warehouse distributors are completely irrelevant to the question of "cost justification" as it relates to this case. Equally irrelevant is the fact that it may have cost a supplier more to sell to the SCJ members if the SCJ warehouse operation

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made several general statements concerning its understanding of the application of the "cost justification" proviso, statements which could be construed as contrary to the views expressed above. We submit, however, that the Court did not intend to express its views as to the legal result to be reached in this case, but merely directed the Commission initially to make its determination on the issues, something the Court indicated the Commission had not as yet done.

did not exist. These hypothetical costs savings, however, form the basis for petitioners' claim that the price concessions induced and received by them were "cost justified"; they argue that they were entitled to receive the same discount as the warehouse distributors because they performed the same functions as warehouse distributors. We repeat, the question is what differences actually existed in the suppliers' cost of selling SCJ and the suppliers' cost of selling to their direct buying jobbers.

In its findings and opinion the Commission carefully cites the evidence supporting its findings and sets forth a full analysis of the cost justification issue. Petitioners contend, however, that the Commission's statement of the cost saving features of this case "ignores and omits entirely the function of purchasing, warehousing merchandise and breaking bulk" (Pet. br. p. 18). This contention is completely erroneous.

*Warehousing.* The Commission fully discussed warehousing costs at pages 20-26 of its findings. It pointed out that SCJ's warehousing would save a manufacturer at most 5 to 6 percent and that this would be true only in those instances where the manufacturer maintained a local warehouse for customers and SCJ saved the manufacturer such costs by purchasing merchandise direct from the factory. Actually, the overwhelming majority of manufacturers who testified on the subject stated that SCJ normally purchased from the local warehouse (Tr. 1082, 1083, 1203, 1256, 1283, 1404). Clearly in those instances where a manufacturer rented space in a com-

mercial or "fee" warehouse, there would be no savings whatsoever since the manufacturer would be charged the same fee whether the goods were picked up by SCJ or picked up by individual direct buying jobbers.

In those cases where the manufacturer owned and operated his own local warehouse, any savings in warehousing costs enjoyed by manufacturers by virtue of SCJ's warehousing functions has been minimized by SCJ's policy of having a high turnover rate of inventory. John F. Dixon, general manager of SCJ stated (R. 2077) :

"A. As I testified yesterday, we have stock, or it has been my recommendation to the Board of Directors that we patronize local manufacturers, rebuilders or manufacturers that have local warehouses. This is one of them. Our trucks call on there [sic] on a competitive brand for our jobbers everyday, and while we are there, we can pick up our stock orders by the week, by the month, everyday, if necessary.

Q. So that runs it through real fast, doesn't it?

A. Yes, sir."

The record shows that the inventory turnover of independent warehouse distributors in Los Angeles ranged from three to five a year in all lines (Tr. 1459, 1570, 1732, 1801, 1943). It is undisputed that SCJ's turnover, however, averaged seven times a year, and in the case of the 50 highest of the 70 auto parts lines carried, the turnover rate exceeded eight. In the case of the 30 lines with the highest annual turnover, the average was 10.31 times a year and the

amount of merchandise in these lines exceeded 50 percent of petitioner's sales volume for 1963. In the ten highest lines, the turnover was 21 times a year or more often.<sup>37</sup>

It is true that five of petitioners' suppliers reduce the warehouse distributor discount if the group purchases from the local warehouse rather than the factory (CX 223, pp. 12, 22, 32, 45, 61). But, as the Commission noted (Comm. Findings, p. 24), the initial discount is so great that the reduction is relatively insubstantial. Thus in the case of Standard Motor Products, the initial discount is 26 percent, but if the purchase is from the local warehouse it is 21 percent (CX 223, p. 63, Tr. 4183). Although SCJ made some purchases from the factory, thereby saving Standard approximately five percent, this does not justify receipt of the remaining 21 percent.<sup>38</sup>

*Breaking bulk.* The direct buying jobber purchasing from the supplier's local warehouse buys in case lots if that is the policy of the warehouse. There could be no savings to the supplier merely because it

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<sup>37</sup> Figures taken from CX 225 and tabulated at page 23 of the Commission's Findings.

<sup>38</sup> Petitioners erroneously state that the only testimony about Standard Motor Products was given in 1959 and dealt with brokerage type transactions (Pet. br. 18 n. 4). Actually, Mr. Chadwick, district manager of Standard Motor Products, testified in the remand proceedings concerning sales expenses. His testimony supports the Commission's findings (Tr. 2024, 2037). As to warehousing expenses, exhibits introduced after the remand of this case were the basis of the Commission's tabulation showing an analysis of discounts received from Standard Motor Products for the year 1963 (Comm. Findings pp. 24-25, Tr. 4043-4044, CX 227b-CX 289b).



cost SCJ to break bulk and repack merchandise to distribute to its members (Tr. 1368-69). In those instances where jobbers do order in quantities less than a case, and require the manufacturer's warehouse to break a case and repackage merchandise, the savings in cost due to SCJ's method of purchasing would be a portion of the 5 or 6 percent maximum savings due to warehousing already discussed.

*Billing and credit.* Any cost savings in this area are small, as indicated by the fact that SCJ was able to take over this function and at the same time operate a warehouse and still have total expenses of only six percent, which is approximately the fee charged by commercial warehouses in this industry. Therefore the cost to SCJ for billing and credit functions probably represents a small proportion of its costs of operation. While the buyer's costs are not necessarily indicia of the savings in cost to the supplier, in this particular category the two would appear to be commensurate.

In their brief, petitioners paraphrase or quote certain excerpts from the testimony of various witnesses (Pet. br. pp. 19 et seq.). It is difficult to see how this testimony helps petitioners. For example, Mr. Bolander of the Thermoid Division of H. K. Porter Company is quoted as stating that SCJ performs the same services as other warehouse distributors but that he calls on SCJ members to a *greater* extent than direct jobbers because sales to SCJ members are greater (Pet. br. 19-20). Even though as to this particular supplier's line of products SCJ may have relieved the supplier of space in his own warehouse

(Tr. 1086-87), this does not detract from the support for Commission findings. The Commission recognized that there could be some savings in this regard, but that such savings would not in any case exceed 5 or 6 percent, since suppliers operating their own warehouse always had the option of paying public warehouses to provide the same service at such cost (Comm. Opinion, p. 13).

Mr. Fleer, of the American Hammered Division of the Sealed Power Corporation also testified that he calls on SCJ members to the same extent as direct jobbers of comparative size (Tr. 1213). The fact that he also calls on indirect jobbers to the same extent (Tr. 1160) does not detract from this. At best it simply shows that, as in the case of SCJ, his warehouse distributors saved him little expense in this regard. This witness is also cited as stating that his company has a substantial "savings" in prepayment of freight costs due to SCJ's picking up its orders at their warehouse (Tr. 1294). This does not amount to a "difference" in costs *vis à vis* direct jobbers, since the latter do not ordinarily buy in quantities large enough to qualify for his company's prepayment of freight plan (Tr. 1206). Therefore, any "savings" did not justify any part of the 20 percent price differential but simply eliminated a further discrimination in price that would have resulted had SCJ not picked up its orders.

The other testimony of this witness cited by petitioners merely shows that he was satisfied with SCJ as a customer because its volume of purchases increased sales without increasing marginal costs (Tr.



1230, 1299).<sup>39</sup> This, however, does not necessarily effect a cost savings within the meaning of Section 2(a). As the framers of the Robinson-Patman Act well knew, many manufacturers are willing to drop prices to large customers simply because marginal costs to such customers appear to be small. This method of "justifying" lower prices to selected customers is inherently unfair to other customers and is not permitted under the Act.<sup>40</sup> Selections from the testimony of the other manufacturers cited by petitioners are subject to the same explanation.

While it is true that manufacturers were able to mention some areas in which SCJ relieved them of costs (billing and warehousing) none claimed that the functional discounts granted petitioners were in fact fully or even substantially cost justified (*e.g.*, Tr. 1246, 1267, 1415). Indeed, none claimed that

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<sup>39</sup> "Marginal" cost is the additional cost to a manufacturer to increase production after all the general overhead costs have been previously allocated. Rowe, *Price Discrimination Under the Robinson-Patman Act* 281 (1963).

<sup>40</sup> See statement by Representative Utterback, Chairman of the House conferees, immediately before passage of the bill, concerning the meaning of the "difference in costs" proviso of Section 2(a) (80 Cong. Rec. 9417 (1936)):

Such a difference cannot be claimed on the basis of a difference in cost in the seller's entire business with and without the purchases of the customer in question. If his purchases so increase the seller's volume as to make possible a reduction in unit cost upon his entire business, other customers are entitled to share also in the benefit of that reduction.

See also Senate Report No. 1502, 74th Cong. 2d Sess. 5-6 (1936); H. R. Rep. No. 2287, 74th Cong., 2d Sess. 10 (1936).

cost justification was even the basis for any of their functional discounts. Such functional discounts were not made available to direct buying jobbers who might also choose to render some degree of cost savings services. (See Comm. Opinion, p. 17; Tr. 1368-69, 1417-18, 1488-89).

In sum, the only reasonable conclusion is that SCJ was granted a warehouse distributors discount simply because SCJ possessed the external trappings of a warehouse distributor and, more importantly, had a substantial number of precommitted members as purchasers. It made good "business sense" to suppliers to accede to petitioners' demands that they be given a warehouse distributors discount, because once a particular line of auto parts was approved and accepted by the board of directors of SCJ, they were virtually assured that no competing lines would be carried (see, *e.g.*, Tr. 1251). That this is the way automotive parts manufacturers generally think is noted by Professor Charles N. Davisson in Chapter 24 of his study, *The Marketing of Automotive Parts* (1954).<sup>41</sup> But it is precisely this general business

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<sup>41</sup> Professor Davisson observes that this method of pricing is opposed to the requirements of the Robinson-Patman Act at pp. 919:

In evaluating the desirability of expanding the distribution pattern to include additional channels and thereby to achieve broader market representation, management is most likely to think in terms of marginal profit. In short, the profitability of the new channel is measured by subtracting the expected additional costs incurred in selling the new channel from the additional sales anticipated. This incremental approach is inher-

desire to capture large volume accounts by price concessions that led Congress to pass the Robinson-Patman Act.

Petitioners also cite testimony of representatives of warehouse distributors to the effect that in their opinion their operations fully justified the functional discount which they received. This is beside the point since the issue is whether the discounts received by SCJ are cost justified *vis à vis* direct buying jobbers. The warehouse distributors are bound to look with favor upon the discounts *they* receive. As to the issue of SCJ's discounts such testimony is necessarily lacking in probative force. The more reliable evidence is the testimony by the very manufacturers who sell to both SCJ and direct buying jobbers, and this is the evidence upon which the Commission based its decision.

Moreover, the testimony of these warehouse distributors is not inconsistent with the Commission's findings. For even if one assumed that discounts received by warehouse distributors are cost justified,<sup>42</sup> it must be noted that they perform at least one important service for manufacturers that SCJ does not render, namely, the active solicitation of new jobber accounts, or "creative selling" as it is often called. SCJ maintains an essentially static membership,

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ently inconsistent with a policy of basing prices on the differences in the average costs of selling different classes of accounts, which policy results in uniform margins.

<sup>42</sup> In fact, as previously noted, *supra* pp. 44-45, there is every reason to believe that the functional discounts received by warehouse distributors are not cost justified.

does not sell to non-members, and never employed a salesman until very late in this proceeding (*supra*, p. 12). Warehouse distributors, on the other hand, employ several salesmen for this purpose. Those salesmen visit, sell, and service from 300 to 600 jobbers (Tr. 1130, 1234-35, 1550, 1762, 1777, 1792) and are paid high salaries, as selling is one of the primary functions warehouse distributors perform for manufacturers (Tr. 1069-73, 1151-62, 1225, 1471-72, 1516, 1614, 1749-50, 1812).<sup>43</sup> Quite probably this expense accounts for a significant portion of the difference in operating costs between SCJ and public warehouses on one hand (6 percent) and warehouse distributors on the other hand (17 to 18½ percent) (Tr. 1825-26).

Petitioners' argument that it is the volume of sales of the manufacturer's product that counts and not the number of salesmen employed is not a satisfactory reply for purposes of the Robinson-Patman Act.

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<sup>43</sup> Commission Elman's dissent is based on the initial assumption that "SCJ is a legitimate warehousing distributor" (op. p. 1). Aside from the fact that the Act deals with competitive realities, rather than functional labels assigned to customers, *Federal Trade Commission v. Ruberoid Co.*, 343 U.S. 470, 474-75, (1952), the statement apparently does not take into consideration the fact that SCJ does not engage in promotional selling and widespread distribution to all interested jobbers (as do warehouse distributors), but renders its services only for those who are its owner-members. As a practical matter, membership in SCJ is difficult to come by, *supra* p. 10. One manufacturer's representative was in fact dissatisfied with SCJ because in his opinion it did not fully perform the functions of warehouse distributors (Tr. 1891-1915).

Since manufacturers still found it necessary to continue sending representatives to SCJ jobbers to advise on technical problems, check price catalogs and inventory and advise on new lines (*supra*, pp. 11-12), there has been no saving to manufacturers in this regard.<sup>44</sup>

Although we submit that the record is clear that none of the discounts received on the more than 70 lines carried by petitioners were cost justified, it is sufficient to sustain the Commission's order that the price differentials granted by any *one* of the suppliers failed to meet the requirements of Section 2 (a). See *Federal Trade Commission v. Morton Salt Co.* 334 U.S. 37, 49 (1948); *Moog Industries, Inc. v. Federal Trade Commission*, 238 F.2d 43, 51-52 (8th Cir. 1956); *E. Edelmann & Co. v. Federal Trade Commission*, 239 F.2d 152, 155 (7th Cir. 1956), *cert. denied*, 355 U.S. 941.

The record shows that petitioners knew or should have known that the challenged discriminations induced by them could not be "cost justified." Petitioners do not challenge the Commission's finding in

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<sup>44</sup> Cf. *General Auto Supplies, Inc. v. Federal Trade Commission*, 346 F.2d 311, 316 (7th Cir. 1965):

The essential purpose of a warehouse distributor is to sell the product sold to it by suppliers and the primary purpose of its functional compensation is for this service. But National did not sell, except for 6% of its 1961 business which consisted of commission sales to non-partner jobbers. That National's function was not to sell is emphasized by the fact that it made no effort to do so and that the sales efforts were actually made by the suppliers themselves or their sales representatives.



this respect (Comm. Findings, pp. 26-28).<sup>45</sup> Although petitioners may well have thought that as a matter of law they were entitled to the warehouse distributor discount under their theory of the "cost justification" defense, the fact that such a theory was incorrect does not make petitioner less knowledgeable as to the facts. They are assumed to know the legal consequences which flow from those facts. *Automatic Canteen Co. v. Federal Trade Commission*, 346 U.S. 61, 80 (1953); *Fred Meyer, Inc. v. Federal Trade Commission*, 359 F.2d 351, 364-65 (9th Cir. 1966); *General Auto Supplies, Inc. v. Federal Trade Commission*, 346 F.2d 311 (7th Cir. 1965).

That the price differentials received by petitioners have the proscribed effect on competition has never been disputed by petitioners. The discriminatory discounts of 20 percent or more which were passed on in substantial part to the jobber-members are plainly substantial, *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37, 46-47, 50-51 (1948). The requisite injury may be inferred from systematic

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<sup>45</sup> " \* \* \* The Commission need only show, to establish its prima facie case, that the buyer knew that the methods by which he was served and quantities in which he purchased were the same as in the case of his competitor. If the methods or quantities differ, the Commission must only show that such difference could not give rise to sufficient savings in the cost of manufacture, sale or delivery to justify the price differential, and that the buyer, knowing these were the only differences, should have known that they could not give rise to sufficient cost saving \* \* \*." *Alhambra Motor Parts v. Federal Trade Commission*, 309 F.2d 213, 219 n. 8 (9th Cir. 1962), quoting the Supreme Court's opinion in *Automatic Canteen Co. v. Federal Trade Commission*, 346 U.S. 61, 80 (1953).

and substantial price discriminations in a keenly competitive market characterized by narrow profit margins. See, e.g., *E. Edelman & Co., v. Federal Trade Commission*, 239 F.2d 152, 155 (7th Cir. 1956); *cert. denied*, 355 U.S. 941 (1958); *Fred Meyer, Inc. v. Federal Trade Commission*, 359 F.2d 351, 365 (9th Cir. 1966).<sup>46</sup>

We submit that the Commission findings that the price discriminations petitioners induced and received from their suppliers were not "cost justified" within the meaning of Section 2(a) of the Clayton Act, and that petitioners were so aware, are not only supported by substantial evidence, but are the only findings possible on the record in this case. Clearly, petitioners violated the provisions of Section 2(f) of the Clayton Act.

**IV. Contrary to petitioners' contentions the Commission does not regard cooperatives as *per se* illegal nor does the Commission's order threaten the existence of cooperatives.**

This case simply stands for the proposition that jobbers cannot use a cooperative as an instrumental-

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<sup>46</sup> Petitioners, quoting from Commissioner Elman's dissenting opinion (p. 15), argue that in effect the result in this case is to preserve inefficient methods of distribution and prevent elimination of unnecessary middlemen's costs (Pet. Br. 14-15). While increased efficiency and decreased costs of distribution are in the public interest, protection of jobber competition is required under the Act. Moreover, petitioners' argument is misplaced in the circumstances of this case where the decreased costs of distribution are not passed on to the dealer and consumer but are withheld by the favored jobber in the form of larger profits.



ity by which to combine their purchasing power to induce and receive discriminatory prices and allowances that may have the effect upon competition proscribed by Section 2(a) of the Act, any more than they can use any other form of business organization to achieve the same goal.

The violation found in this case was due to the fact that in the auto parts industry margins of profit are slim and the suppliers of auto parts to SCJ sell directly to many jobbers and to petitioners without a significant difference in costs to the suppliers—or at least enough to justify a 20 percent price differential.

It is predominantly in the auto parts industry that such facts exist with regard to buying groups. The same facts may not pertain to other industries. Thus in *Central Retail-Owned Grocers, Inc. v. Federal Trade Commission*, 346 F.2d 410 (7th Cir. 1963), a case cited by petitioners involving a wholesale grocery cooperative, the Commission did not allege injury to competition. Indeed, it was not even charged that discriminations in price occurred. The charge against the cooperative was that it took over functions previously performed by independent brokers and in receiving similar discounts from suppliers it was receiving “brokerage” commissions in violation of Section 2(c) of the Act. (Under Section 2(c) receipt of such commissions by a buyer’s representative is illegal regardless of injury to competition and regardless of any cost justification, *Federal Trade Commission v. Broch*, 363 U.S. 166 (1960)). The

court reversed solely on the ground that there was insufficient evidence that the discounts were intended as brokerage fees or discounts in lieu thereof. It is therefore inaccurate for petitioners to cite this case as bearing on the issues here. The very court that rendered the decision in *Central Retailers*, subsequently upheld the Commission in the *National Parts Warehouse* case, which involved essentially the same issues present here (*supra*, pp. 23-24). The court itself considered *Central Retailers* as "inapposite." *General Auto Supplies, Inc. v. Federal Trade Commission*, 346 F.2d at 317.

Even in the auto parts industry, where this and other buying group cases have arisen, there has been no intention to put cooperatives out of business if they actually render cost savings functions for suppliers. The "cost justification" proviso is "implicit in every order issued under the authority of the Act, just as if the order set [it] out *in extenso*" *Federal Trade Commission v. Ruberoid Co.*, 343 U.S. 470, 476 (1952).<sup>47</sup>

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<sup>47</sup> In *Mueller Co. v. Federal Trade Commission*, 323 F.2d 44 (7th Cir. 1963), *cert. denied*, 377 U.S. 923, the court upheld the Commission's finding that certain discounts granted to jobbers for warehousing functions were not cost justified under the Act. The court, in responding to the argument that the Commission's order would prevent manufacturers from providing discounts in payment for valuable warehousing functions, said (p. 47):

The Commission's order, although written in broad terms, is based on and is limited by \* \* \* findings of fact. The Commission order cannot do away with statutory defenses provided by the Robinson-Patman Act. The Com-

Furthermore, earlier this year, the Commission entered into consent order agreements with two jobber-owned cooperatives doing business in the auto parts industry in the same manner as SCJ.<sup>48</sup> The Commission agreed with these groups that if membership in the cooperatives was thrown open to jobbers, without imposing financial barriers to membership, no injury to competition could be claimed since any lower prices procured by the cooperative would be available to competing jobbers in the area. See *Tri-Valley Packing Association v. Federal Trade Commission*, 329 F.2d 694, 703-704 (9th Cir. 1964). On April 7, 1966, petitioners were notified of these impending settlements and opportunity has been available to them since then to settle the case on this basis (See Appendix C, *infra* pp. 8a-10a). Petitioners declined such a settlement. (See Appendix C, *infra* pp. 11a-12a, letter from petitioners' counsel). Admittedly, petitioners had every right to decline settlement and pursue the present appeal. Nevertheless, we point the matter out to refute the claim by petitioners that the Commission is "trying to put cooperatives out of business" (Pet. br. p. 43).

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mission, in its brief, referring to the practice of compensating jobbers who perform a warehousing function, states: "\* \* \* this is a perfectly proper procedure, provided it be done in a fair and legal manner.' We approve the order on that basis.

<sup>48</sup> *Nor-Cal Distributors, Inc. et al.*, (consent order) Dkt. No. C-1062, 3 CCH Trade Reg. Rep. ¶ 17524 (April 29, 1966); *Evergreen Warehouse Distributors, Inc. et al.*, (consent order) Dkt. No. C-1070, 3 CCH Trade Reg. Rep. ¶ 17563 (June 1, 1966).

As stated before, petitioners, although small businessmen, are generally larger and financially better off than their non-affiliated jobber competitors. Their prosperity has been reaped through lower prices at the expense of their competitors. What the Commission said in regard to a similar buying group in the *National Parts Warehouse, supra*, is apropos here:<sup>49</sup>

We are not unaware of the fact that such operations can frequently enable groups of small merchants to duplicate some of the efficiencies of the larger, single-entity enterprises, and we are certainly not unsympathetic toward the efforts of any organization, "buying groups" or otherwise, to achieve savings of this kind. Yet it is our task to find the facts as they exist, and apply with an even hand the law as Congress has given it to us, rather than condoning violations of law merely because they have been committed by the small businessmen who are otherwise the special wards of the various antitrust and trade regulation laws. \* \* \* The law's concern for the small businessman is great, but it certainly does not sanction his receipt of discriminatory prices that favor him at the expense of competitors who are as small as, or smaller than, himself.

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<sup>49</sup> CCH Trade Reg. Rep. (1963-1965 Transfer Binder) at p. 21,619.

## CONCLUSION

For the foregoing reasons the Commission's order should be affirmed and enforced.<sup>50</sup>

Respectfully submitted.

JAMES MCI. HENDERSON,  
*General Counsel,*  
J. B. TRULY,  
*Assistant General Counsel,*

MILES J. BROWN,  
JEROLD D. CUMMINS,  
*Attorneys,*

*Attorneys for Federal Trade Commission.*

*Washington, D.C.*

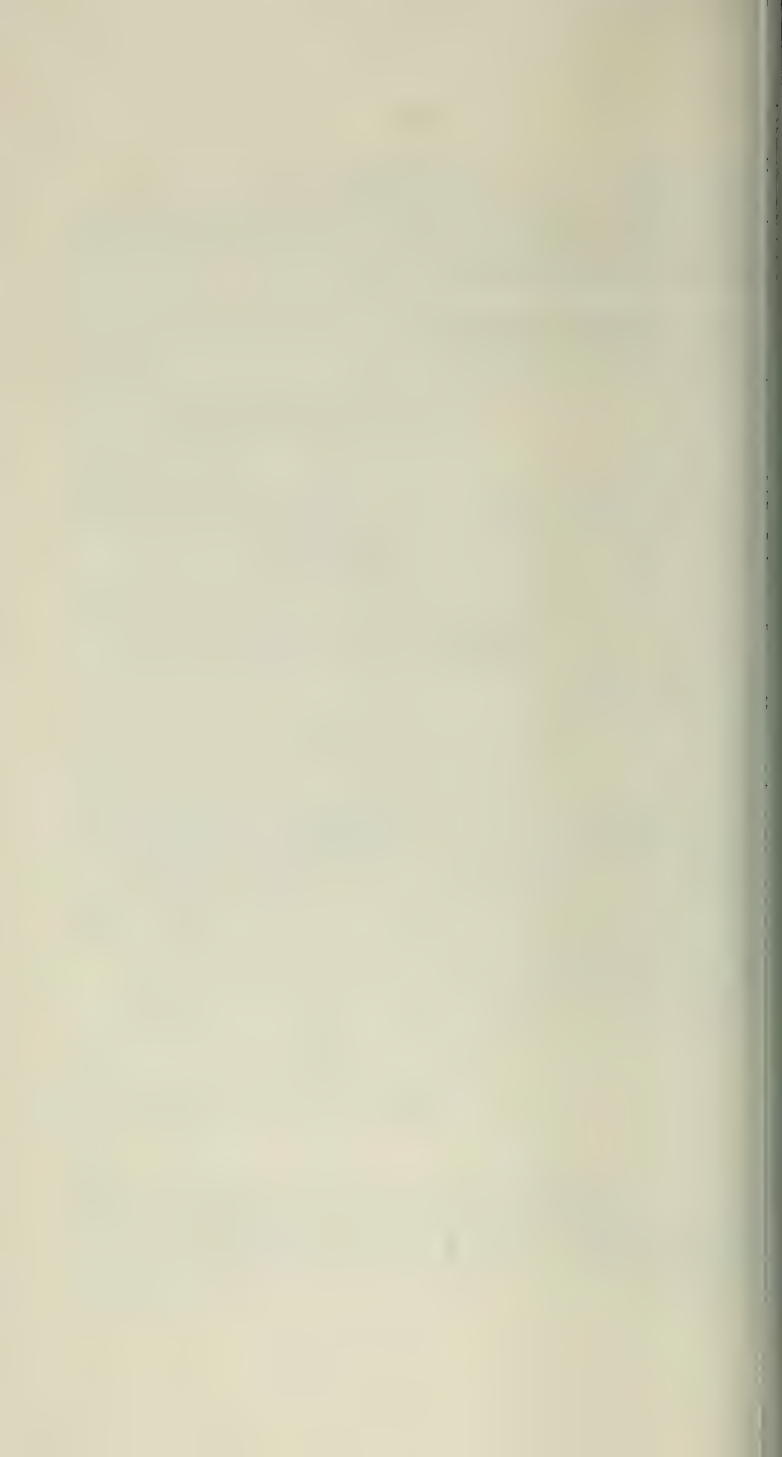
## CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JEROLD D. CUMMINS  
Attorney for the  
Federal Trade Commission

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<sup>50</sup> "To the extent that the order of the commission . . . is affirmed the court shall issue its own order commanding obedience to the terms of such order of the commission." Section 11(c) Clayton Act, 73 Stat. 243, 15 U.S.C. 21(c).



## **APPENDIX**





## APPENDIX A

Clayton Act, as amended, Section 2, 49 Stat. 1526,  
15 U.S.C. 13:

(a) \* \* \* it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality \* \* \* where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: Provided that nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacturing, sale or delivery resulting from the differing methods or quantities in which such commodities are to such purchases sold or delivered \* \* \*.

(d) \* \* \* it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(f) \* \* \* it shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

Clayton Act, as amended, Section 11, 73 Stat. 243, 15 U.S.C. 21:

(a) \* \* \* authority to enforce compliance with sections 2, 3, 7, and 8 of this Act by the persons respectively subject thereto is hereby vested in the Interstate Commerce Commission where applicable to common carriers subject to the Interstate Commerce Act, as amended; in the Federal Communications Commission where applicable to common carriers engaged in wire or radio communication or radio transmission of energy; in the Civil Aeronautics Board where applicable to air carriers and foreign air carriers subject to the Civil Aeronautics Act of 1938; in the Federal Reserve Board where applicable to banks, banking associations, and trust companies; and in the Federal Trade Commission where applicable to all other character of commerce \* \* \*.

(c) Any person required by such order of the commission or board to cease and desist from any such violation may obtain a review of such order in the court of appeals of the United States for any circuit within which such violation occurred or within which such person resides or carries on business, by filing in the court, within sixty days after the date of the service of such order, a written petition praying that the order of the commission or board be set aside. \* \* \* The findings of the commission or

board as to the facts, if supported by substantial evidence, shall be conclusive. To the extent that the order of the commission or board is affirmed, the court shall issue its own order commanding obedience to the terms of such order of the commission or board.

Robinson-Patman Act, as amended, Section 4, 49 Stat. 1528, 15 U.S.C. 13b:

\* \* \* nothing in this act shall prevent a co-operative association from returning to its members, producers, or consumers the whole, or any part of, the net earnings or surplus resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association.

## APPENDIX B

**Further excerpts from legislative history dealing with applicability of the Robinson-Patman Act to wholesale cooperatives\***

At the time of the passage of the Robinson-Patman Act (1936) Congress had under consideration a series of studies on distribution in the food industry compiled by the Federal Trade Commission. One of these studies dealt specifically with wholesale cooperatives and showed among other things that out of 150 retailer-owned cooperatives 40 owned a warehouse and 53 rented a warehouse. See Senate Document No. 12, 72d Cong., 1st Sess. "Chain Stores Inquiry—Cooperative Grocery Chains" (1932) at pp. 11, 49. During hearings on the Patman bill the following explanations given by Representative Patman show that, although he was primarily concerned with the chain stores, he was also insistent that cooperatives were likewise subject to the requirements in the bill:

Mr. McLaughlin. In some communities a number of stores, for instance, grocery stores, group together in what they call independent merchants' associations, or something of that kind. Now, these people are all citizens of the community. Each man, as I understand it, owns his own individual store, but he groups together in a large buying group in order to buy in quantity as suggested by our chairman. Would this bill work any hardship on that group at all?

\* \* \* \*

Mr. Patman. That group is called "voluntaries." They get together for self-protection.

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\* See *supra* p. 41.

Under the present system, they are to be commended and encouraged. They get together and will have one jobber and will either deposit money with that jobber to enable him to have sufficient funds to purchase their goods at quantity prices and warehouse them or form a separate corporation and buy stock in it. There are several different ways of forming voluntaries. While it is true they get part of the benefits that the chains get by doing that, through their mass purchasing power, at the same time they do not get all of the benefits and they cannot continue to exist indefinitely that way. Some of them might meet the competition for a while, but the corporate chains still have too much advantage over them. Here is the set-up now: The corporate chains have an advantage over both the voluntaries and the independents, but in either case the independent is gone.

Mr. McLaughlin. I think it would be helpful to the committee, perhaps, if you would define "independent."

Mr. Patman. I am talking about the store that is locally owned and usually owner operated or owner controlled.

Mr. McLaughlin. And not associated with other stores in a buying arrangement?

Mr. Patman. That is right—locally owned and owner operated.

\* \* \* \*

\* \* \* Let me tell you about the voluntaries: They think they can compete with the chains, but they cannot do it, and that is one of the reasons they cannot. But suppose the voluntaries do succeed, then you have just the voluntaries and the chains; the independent is out. In



either event, the independent is gone, unless you pass some kind of law to protect him, one that will give him equal rights.

\* \* \* \*

Mr. Celler. Would your bill militate against these voluntary chains, or prevent their getting rebates?

Mr. Patman. It would give them the same benefits as the independents, give the same benefits as the chains. Like it is now, they have an advantage over the independent, and the chain has an advantage over the voluntary.

Mr. Celler. Where is the language that undertakes to give that protection to the voluntary chains?

Mr. Patman. That is quantity purchases. We have an amendment which Mr. Teegarden will suggest here that will take care of that. Like it is now, the voluntaries have an advantage over the independents and the corporate chains have an advantage over the voluntaries. But in either event, the independent is gone, he cannot last, he is out of the picture.

Mr. Teegarden, who was the counsel for the United States Wholesale Grocers Association and who helped draft the bill, explained in a letter printed by the Committee a few pages later:

The bill affords a further protection to independent retailers and wholesalers in their purchases in competition with chains, since it enables them by pooling their purchases, to demand the same prices and terms that are accorded chains on purchases in similar quantities and under similar methods of delivery.

\* \* \* \*



The Clayton Act as it now stands expressly permits quantity price differentials whether supported by differences in cost or not. This bill prohibits them unless supported by differences in cost, . . . And it must be not merely a bookkeeping savings figured out on paper from the fact that the chain has not immediately used certain facilities which the manufacturer must maintain anyway. It must be a direct savings "resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

—Hearings on H.R. 8442, H.R. 4995, and H.R. 5062 before the House Committee on the Judiciary, 74th Cong., 1st Sess. pp. 11-13, 34-35 (1935).

In construing and applying regulatory legislation, it is proper for courts to consider the conditions existing at and prior to the time of its enactment as revealed by hearings before congressional committees and reports submitted to Congress by Government agencies. See, *e.g.* *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 10-11 (1923). Just recently, on another question of interpretation of the Act, the Supreme Court relied on explanations given by Representative Patman and Mr. Teegarden during the hearings and debates on the bill. See *Federal Trade Commission v. Borden Co.*, 383 U.S. 637, 641, 643 (1966).

## APPENDIX C

The following is a letter from the Federal Trade Commission to petitioners' counsel, notifying him of the Commission's willingness to allow buying cooperatives to continue to receive redistribution discounts as in the past, provided membership is effectively open to all jobbers.

April 7, 1966

Harris K. Lyle, Esq.  
Attorney at Law  
14416 Hamlin Street  
Van Nuys, California 91401

"Re: Alhambra Motor Parts, et al. v. Federal Trade Commission, 9th Cir. No. 20,764—FTC Docket 6889

Dear Mr. Lyle:

The February 28, 1966, issue of *Supermarket News* carried an article quoting you to the effect that the Federal Trade Commission is threatening the existence of "co-ops," and that you would be interested in negotiating a settlement with the Federal Trade Commission, "but there is nothing to negotiate." It further quoted you as stating: "Complete surrender is the FTC's interpretation of negotiating. If we lose this case, we'll be out of business." I have some information that was not available to you when you made these observations and which I believe will convince you that the Commission is not attempting to drive cooperatives out of business and furthermore that there is definitely room for negotiating if your clients' main concern is to retain the cooperative form of doing business.

The Commission is currently in the process of negotiating settlements by consent order procedure of investigations of two buying cooperatives on the West Coast for alleged violations of Section 2(f) of the Clayton Act. As in the case of your clients, those cooperatives were formed by jobber distributors of automobile parts. And, as the Commission found in connection with Southern California Jobbers, Inc. (Findings, pp. 9-10), the financial requirements for membership in these buying organizations are high and for this reason there have been instances where membership has been denied jobbers who do business in the same territory covered by members. The jobber members, by virtue of the passing on of warehouse distributor discounts in the form of rebates, have received substantially lower prices than have been available to other direct-buying jobbers in the same area.

Recently these two groups submitted to the Commission plans to change their method of doing business in an effort to comply with the requirements of Section 2(f). Their proposal is to open their membership to any bona fide jobber in the area, thereby making the lower prices available to all competing jobbers. The Commission has agreed that, upon certain conditions, this change would eliminate the probability of injury to jobber competition and would constitute compliance with the cease and desist order contained in the proposed consent order agreement.

The conditions upon which the Commission has agreed to accept the proffer of compliance are in substance: (a) that the cooperative eliminate membership fees (the investment of pres-

ent members to be paid back over a period of time with interest), (b) that all jobbers in the trade area be notified that membership is now open, (c) that patronage dividends not be withheld from members on a discriminatory basis, (d) that the cooperative not engage in dropshipping except in very real emergencies, and (e) that the cooperative operate an adequate warehouse for serving its members. I have enclosed a copy of one of the proposed consent order agreements. The other is virtually the same. Also enclosed is a copy of the compliance settlement in *National Parts Warehouse*, Docket 8093, which is mentioned in the proposed consent agreement referred to above.

Since these two matters probably will be settled in the near future, I believe you should be notified so that you and your clients may consider the basis on which they are to be settled and have an opportunity to submit similar proposals if you see fit.

If you are interested in negotiating a settlement, I believe the Commission would accept a report of compliance along the lines discussed above. If you have any questions about this matter, please feel free to communicate with me. If it should develop that a conference is needed and it is inconvenient for you to travel to Washington, we can arrange to send an attorney to your office.

Sincerely yours,

/s/ J. B. TRULY

Assistant General Counsel

Counsel for petitioners replied to the above letter as follows:

May 3, 1966

J. B. Truly, Esq.  
Assistant General Counsel  
Federal Trade Commission  
Washington, D. C. 20580

“Re: Alhambra Motor Parts, et al. v. Federal Trade Commission

Dear Mr. Truly:

We have your two letters dated April 7th and 22nd, 1966. With regard to your question on the 9th Circuit Courts procedure, I believe your assumption is correct. However, I have asked Mr. Wilson to confirm this opinion and have been expecting an answer daily. In any event, I have mailed another copy of our Petition for Review under separate cover.

Turning now to your suggestion to discuss the Evergreen settlement, we see several serious questions. It does not appear to us that the proposal offers a firm foundation for a permanent settlement. Nor do we understand the reasoning whereby the cooperative gives up its working capital and opens its membership to everyone at no cost. What is the theory that everyone is equal at no cost, but unequal at \$9,000.00? Surely there is no justification in the statutes for saying that a business man is not entitled to use the facilities he pays for, even though some less successful competitor cannot or does choose to buy cost saving devices or equipment.

Opening the membership would also pose a very practical problem. No single warehouse can



serve more than a small fraction of the jobbers in a given area. What position will the Commission take if Evergreen, having accepted 4, 8 or 12 new members, finds itself at the limit of its capacity and declines to accept any more members? Will this be called discrimination? New facilities or increasing the size of the existing warehouse is not an answer because your conditions prevent any new capital levies. The same rule prevents formation of a new co-op.

And why are drop shipments forbidden? These are commonly used by all warehouses and we can see no reason to discriminate against cooperatives.

It is our intention to comply strictly with any valid order (or any agreement). SCJ has complied to the letter with the existing cease and desist order against drop shipments or brokerage. Complaint counsel seem to be convinced this is not so, but the reason they could not find any evidence is because there isn't any.

If you believe further negotiation would serve a useful purpose, we will cooperate in an effort to solve the problems, but we will expect that our objections to the Evergreen settlement must be taken into account.

Very truly yours,

LYLE & DI GIUSEPPE

/s/ Harris K. Lyle

N O. 2 0 7 6 4  
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ALHAMBRA MOTOR PARTS, et al. ,

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FEDERAL TRADE COMMISSION,

Respondent.

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PETITIONERS' REPLY BRIEF  
ON  
PETITION TO  
REVIEW ORDER OF  
FEDERAL TRADE COMMISSION

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**FILED**

DEC 5 1966

WM. B. LUCK, CLERK

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FEB 1 1967





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SUMMARY

Petitioners submit that the Respondent's Brief is based upon strained interpretations of the law, not warranted by the evidence.

We reiterate our contentions that:

- (1) SCJ, not its members, is the purchaser;
- (2) Section 4 prevents distribution of earnings from being a price discrimination;
- (3) The Commission has failed to sustain the burden of proof that the warehouse discount is not cost



justified; and

- (4) The attempt to eradicate cooperatives is beyond the powers granted to the Commission.

## I

### THE PURCHASER ISSUE

The Commission insists there is substantial evidence to support a finding that the jobber members, rather than SCJ itself, are the purchasers of the merchandise.

This evidence consists of the simple fact, always admitted, that SCJ is a cooperative. From this one fact, it is argued that the cooperative is the agent of its members who therefore become "purchasers". It appears to us that this argument is an unwarranted extension of the meaning of legal terms.

SCJ buys merchandise in large quantities, and pays for it from corporation funds. At this time, no single member is obligated to buy any part of the merchandise and certainly is not bound to pay for any of it.

At the hearing, Complaint Counsel tried to infer that the jobber gave the order and then SCJ went out to buy enough merchandise to fill that order. But an examination of the detailed invoices showing SCJ purchases and sales did not produce a single instance of such a transaction. The only evidence is to the contrary (Huffaker, 1939, Dixon, 20778, Kardas, 2021).

We, therefore, find it difficult to accept a ruling, that when



SCJ buys a carload of tail pipes, and a week or a month later, sells six items to a jobber that SCJ is the agent of the jobber. Is SCJ the jobber's agent for the purchase of the whole carload or only the six items? Certainly, the jobber can only be asked to pay for six. And which of the sixty odd members are principals for that merchandise not sold?

It seems the agency rule is one of convenience, with which the Commission can eradicate cooperatives.

It is argued (Brief, pp. 32-33) that this decision is necessary to close a loop hole. The reasoning is that a cooperative constitutes vertical integration and therefore is guilty of a violation of the Robinson Patman Act.

If the argument is sound, there can be no common ownership at the several functional levels. We know this is a false statement as there are well known instances of manufacturers operating warehouses and also jobbing outlets.

Gulf and Western, and Colyears, are two examples.

Why prosecute cooperatives merely because they are cooperatives?

## II

### SECTION 4 OF THE ROBINSON PATMAN ACT SAYS THAT DISTRIBUTION OF A COOPERA- TIVE'S EARNING IS NOT A VIOLATION.

The argument is that Section 4 allows only distribution of earnings which are the fruit of lawful activity (Brief 34).



Now, an attempt is made to distinguish between the method of distribution and the manner of earning those profits (Brief 36).

This is a little fine spun and really comes down to the same old contention, because it is a cooperative, it is illegal.

SCJ pays warehouse prices. So do other warehouses. It cannot be denied that, these prices being equal, there is no discrimination.

The jobber members buy at jobber prices, again equal and non-discriminatory.

Only when the earnings are distributed can there be any argument of discrimination. Suppose the earnings were not distributed - then there would be no price difference and, of course, no discrimination.

An attempt is made (Brief, 37) to argue that the elimination of a phrase from the Senate version, meant that the section was restricted to allowing pro rata distribution. We disagree; the final version of the Act reads "members, producers or consumers" which is no different from the eliminated phrase.

The authorities cited by the Commission seem to support our contention (Brief, 37, footnote 29). Here it is said:

" . . . it has been held that Congress inserted Section 4 to protect cooperatives from the charge that in granting patronage dividends only to members, they are discriminating in price against non-member patrons within the meaning of Section 2 (a). "

(Emphasis added.)





This fits the case at bar perfectly. The distribution of cooperative earnings to the jobber members is the one thing relied on to show discrimination as against non-members.

We believe the quote in the Brief, pp. 40-41, also supports our position. 1/

In Mr. Patman's remarks referred to in the Brief, p. 41 (Appendix B, 6, a), we think the term "voluntaries" must refer to cooperatives.

In this case, it is the distribution of earnings and nothing else which is the sine qua non of the Commission's argument. Without it, there is no semblance of a discriminatory price differential.

To say that earning the discount is illegal is to go back to this idea that the cooperative is illegal. Certainly, no business can continue if it is not allowed any earnings, ever.

### III

#### COST JUSTIFICATION

The Commission's brief seems to treat this point as if SCJ had the burden of proof. But the evidence must be considered

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1/ See also: Kentucky Rural Electric Co. v. Mahoney Electric Co.,  
282 F.2d 481, cert. den. 365 U.S. 812.

Here the Court said distribution of earnings does not in and of itself constitute a violation even though a return of profit might technically be considered a violation.



under the requirement that Complaint Counsel had this burden. The order confirms this (4034).

The brief (at p. 42), states the Commission found "there was no substantial difference in the methods in which these suppliers sold or delivered products and to direct buying jobbers".

This is more imagination than fact. SCJ buys in carload or truckload lots, but there is no evidence concerning the amounts purchased by direct jobbers. It is common knowledge that larger orders entail relatively less expense than a series of small orders (Webster, 1274; Livoni, 1834).

Obviously, since SCJ purchases more merchandise than other warehouses, it must purchase larger quantities than any individual jobber, and deliveries by the suppliers are made only to the SCJ warehouse.

SCJ serves its members by breaking bulk, without forcing any jobber to buy a case when he doesn't need all of it. See RX 35 and 36 for a demonstration of what it means to break bulk.

We believe the evidence is clear that an individual jobber does not buy in the same manner or in the same quantities as SCJ and any conclusion that there is no difference is unwarranted.

Counsel for the Commission labor over an argument that there is no comparison with so-called independent warehouses. But Mr. Helm, Complaint Counsel, stenuously contended he was going to show that SCJ differed from other warehouses (1008). And this appeared to be the major objective of most of the evidence. A number of straw men were set up.



Catalogs seemed most important, although SCJ never contended it printed catalogs. Nor did it claim it did more or less than any other warehouse in distributing catalogs.

A further argument is made that SCJ utilizes local warehouses which reduces it to the status of a fee warehouse.

However, it is undenied that the manufacturer, not the warehouse, determines whether a particular WD is served by the local warehouse or not (Livoni, 1775; Dixon, 2051).

The big argument is salesmen (Brief, 54-55). Because SCJ does not have a big sales force, it just can't be a warehouse. But we have already pointed out (Opening Brief, 33) that SCJ seems to sell more merchandise than its competitors and it seems to get new customers for the manufacturer (Fleer, 1225; 1298; Costello, 1401, 1423; Webster, 1279).

SCJ members and employees act as salesmen to the other members (Huffaker, 1958-9).

It is interesting to note at this point that two Commissioners, Elman and Jones, and the Trial Examiner, Lewis, were completely satisfied that SCJ performed all the functions of a warehouse distributor. (4080, 4083, 4098, 3814).

It is now argued (Brief 19, 43) that there is no protection for a functional discount, hence it is of no importance to compare SCJ with other warehouses. We think there is good reason for comparison -- does anyone believe manufacturers would sell to warehouses if the latter did not furnish a quid pro quo by selling merchandise and relieving the manufacturer of the duties of





warehousing, breaking bulk, small deliveries, credit, etc. ? Of course, warehouses must not spend all their discount because without profit, they cannot exist.

Furthermore, if as Counsel would have you believe, SCJ is not entitled to as much discount as other warehouses, there arises a situation where a manufacturer is selling two customers at the warehouse level and performing the same functions, at different prices. This is discrimination and, if as is now claimed, the warehouse discount cannot be cost justified, then the prices must be equalized. If SCJ is then allowed an increase, the situation would be as it is today. If the other warehouses must reduce to the SCJ level, they will lose money according to the evidence in this case.

Again, we invite attention to the evidence as a whole. Complaint Counsel compared SCJ with other warehouses. There is no evidence about independent jobbers other than the fact they pay jobber prices.

Much is said about sales representatives calling on SCJ jobbers. But every one of them said they call on all jobbers about the same, whether they are customers of SCJ, or other warehouses, or direct buyers. So, as far as this one fact is concerned, it has no effect on the case. No effort was made by complaint counsel to evaluate the comparative sales expense as contrasted with service.

We submit that Complaint Counsel have failed to present substantial evidence of lack of cost justification and, in place of



evidence, the majority opinion rests only on wishful thinking.

#### IV

#### THE COMMISSION, BY THIS PROCEEDING, IS ATTEMPTING TO PUT COOPERATIVES OUT OF EXISTENCE.

In its Brief (pp. 58-62), it is said that this conclusion is not true, that the Commission only seeks to prevent a cooperative from inducing illegal discounts.

Let us examine how they go about it! First, it is contended that sales are made from the suppliers to the jobbers. Only then can there be any semblance of different prices.

Second, although the evidence is clear that SCJ performs every facet of the business of a warehouse distributor, and that these functions save large sums of money for the supplier, in the case of SCJ, the warehouse discount is not cost justified. Apparently, this is based largely on the lack of a highly paid sales force, regardless of the uncontradicted evidence that SCJ outsells its competitors and does secure new customers for its suppliers.

Lastly, when profits from trading operations are returned to the jobber members, it is called a discriminatory price rebate. Section 4 is swept under the rug!

If a cooperative cannot make and utilize a profit, it cannot exist.

In Central Retail Owned Grocers, Inc. v. FTC, 346 F.2d 410 (7th Cir. 1963), it was held that it could not be inferred that



cooperative earnings were the same as a brokerage.

We contend here, that it cannot be inferred that cooperative profits are the same as an illegal price discount.

Or to put it another way, the profits themselves cannot be the essential illegality.

As to the proffered settlement, we think the Commission is not justified in contending SCJ refused to negotiate.

We asked some questions which have not been answered. The conditions imposed by the settlement (See Appendix C, pp. 9a-10a) are stated as follows:

- (a) Eliminate membership fees (repaying the present members with interest);
- (b) Invite all jobbers to join;
- (c) New and old members to share dividends;
- (d) No drop shipments;
- (e) Maintain an adequate warehouse.

Can a cooperative exist while complying with these conditions?

We think not!

If any great number of new members accept the invitation, the capacity of the existing warehouse will not be sufficient to serve them. The Commission has not answered our question if it would be discrimination to refuse new members who cannot be adequately served. Nor can the cooperative build a new warehouse if deprived of working capital and any means of procuring it.

It would appear that the Commission did not desire to



discuss these questions.

### CONCLUSION

We contend that SCJ, not its members, is the buyer, that there is no substantial evidence that the warehouse discount is not cost justified, that Section 4 prevents the conclusion that distribution of profits is illegal and that the Commission is not justified in exterminating cooperatives.

On this basis, we ask that the complaint be dismissed.

Respectfully submitted,

HARRIS K. LYLE

Attorney for Petitioners

Of Counsel  
LYLE & DI GIUSEPPE

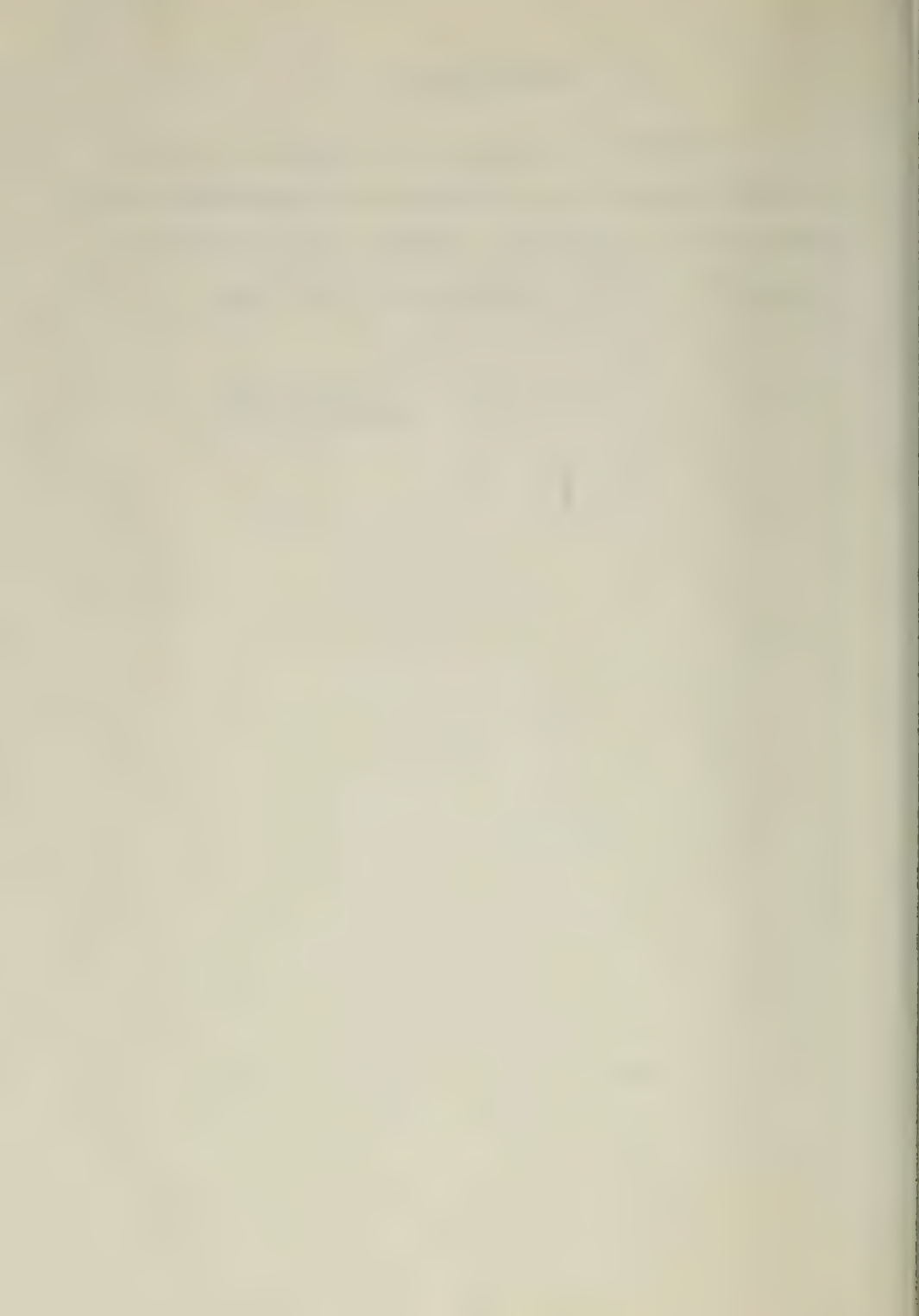




CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Harris K. Lyle  
HARRIS K. LYLE



No. 20,766 /

IN THE

**United States Court of Appeals**

**For the Ninth Circuit**

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SOUTHPORT LAND & COMMERCIAL COMPANY,	}
<i>Appellant,</i>	
VS.	
STEWART UDALL, as Secretary of the Interior,	}
<i>Appellee.</i>	

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On Appeal from the United States District Court  
for the Northern District of California,  
Southern Division

**APPELLANT'S BRIEF**

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**FILED**

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SOUTHPORT LAND & COMMERCIAL COMPANY,	}
vs.	
STEWART UDALL, as Secretary of the Interior,	
	<i>Appellant,</i>
	<i>Appellee.</i>

**On Appeal from the United States District Court  
for the Northern District of California,  
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**APPELLANT'S BRIEF**

---

**JURISDICTIONAL STATEMENT**

Southport Land and Commercial Company (Southport) filed this action in the United States District Court for the Northern District of California, Southern Division, on May 15, 1964, and filed its Amended Complaint in said action on October 6, 1965 (R. p. 6). Jurisdiction in the Court below is based upon 43 U.S.C. Section 1161 et seq. and 28 U.S.C. Section 1331. Venue lies under 28 U.S.C. Section 1391. On November 26, 1965, the Court below, per the Honorable Albert E. Wollenberg, entered its order dis-

missing appellant's Amended Complaint and the action as to defendant Stuart Udall as Secretary of the Interior (R. pp. 30-31). (The action had already been dismissed as to the other defendants on November 18, 1965.) On December 9, 1965, Southport filed its Notice of Appeal herein (R. p. 34). This Court has jurisdiction under the provisions of 28 U.S.C. Section 1291.

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### STATEMENT OF FACTS

The Amended Complaint alleges, inter alia, that Southport is a California corporation and the successor in interest to the Black Diamond Coal Mining Company (R. p. 6); that plaintiff or its predecessor in interest have been in continuous possession of the North one-half of Section 8, Township 1 North, Range 1 East M.D.M. since 1883; that on April 25, 1883, Black Diamond received Cash Coal Entry No. 13 to the above described property; that on May 7, 1883, the Commissioner of the General Land Office purported to cancel and vacate Cash Coal Entry No. 13 without notice or hearing to Southport (R. p. 7).

The Amended Complaint further alleges that plaintiff paid over \$100,000 to acquire title to said property; paid all real property taxes assessed against it; has redeemed the property following tax sales for non-payment of taxes; has been in continuous possession of the property from 1883 to the present time; learned for the first time of said purported cancellation of its entry during a 1961 title search; and

that on March 20, 1963, plaintiff filed with the Bureau of Land Management, Department of Interior, a request for an adjudication that it was entitled to a patent to the property upon principles of justice and equity under 43 U.S.C. Section 1161 et seq. (R. pp. 7-8).

The Amended Complaint further alleges that this request was denied without a hearing by a final administration decision on June 15, 1964; that this decision was based on secret reports, memoranda, and other evidence which defendant Udall has refused and still refuses to disclose to plaintiff; and that defendant Udall acted unconstitutionally and ultra vires his authority in denying plaintiff's petition on the basis of said secret documents and without a hearing.

---

**SPECIFICATIONS OF ERRORS RELIED  
UPON BY APPELLANT**

1. The Court erred in dismissing plaintiff's complaint and the action as to defendant Stewart Udall upon the ground that it did not state facts sufficient for a judicial review of the administrative orders and decisions of said defendant and his predecessors.

2. The Court erred in dismissing plaintiff's complaint and the action upon the ground that plaintiff did not allege facts sufficient to state a claim against defendant Stewart Udall individually and as an officer of the United States.

3. The Court erred in holding that the matters complained of in plaintiff's complaint were within the

sole discretion of defendant Stewart Udall and that the Court had no jurisdiction in this action.

4. The Court erred in holding that the United States is an indispensable party herein.

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### ARGUMENT

**THE DISTRICT COURT ERRED IN HOLDING THAT IT HAD NO JURISDICTION TO ORDER SECRETARY OF INTERIOR STEWART UDALL TO ISSUE A PATENT OR HOLD A HEARING UNDER TITLE 43, SECTION 1161, UNITED STATES CODE.**

**I. APPELLANT IS ENTITLED TO A HEARING UNDER  
43 U.S.C. SECTION 1161.**

The Amended Complaint alleges that appellant's request for an adjudication under Section 1161 was denied without a hearing on January 15, 1964. Section 1161 provides as follows:

The Secretary of Interior, or such officer as he may designate, is authorized to decide upon principles of equity and justice, as recognized in courts of equity, and in accordance with regulations to be approved by the Secretary of Interior, consistently with such principles, all cases of suspended entries of public lands and of suspended preemption land claims, and to adjudge in what cases patents shall issue upon the same.

Although counsel has not been able to locate any decisions defining the type and scope of hearing required by Section 1161, the statute itself furnishes a guide as to the type of hearing required by stating that there must be an adjudication "*upon principles of equity and justice as recognized in courts of equity.*"

The further reference in the statute that the Secretary must “*adjudge in what cases patents shall issue*” manifests a clear legislative intent to require the Secretary to hold a hearing affording the parties the traditional rights permitted in a Court trial, including the right to introduce oral and documentary evidence, to cross-examine adverse witnesses and to argue the case. In referring to this statute, one Court stated:

“Such cases are not left by the law to be finally determined by the land department under the general provisions of the statute, giving to the Secretary of Interior and the commissioner of the general land office control of the administration of the public land business, and vesting those officers with the powers of a special tribunal to determine disputed questions of fact. *On the contrary, the law requires cases of suspended entries to be tried according to the principles of equity, and under definite rules of procedure to be prescribed, and constitutes a different special tribunal invested with power to adjudicate in such cases.*” (Emphasis added.) *Stimson Land Co. v. Hollister*, 75 Fed. 941, 945 (1896).

Moreover, it seems obvious from the language of the statute that it imposes an adjudicatory function upon the Secretary. If so, the hearing conducted pursuant thereto must also meet the minimal standards required by the Administrative Procedure Act as to adjudicatory hearings, 5 U.S.C. Section 1001 et seq.

In every case where a statute requires an adjudication to be determined on the record after opportunity for an agency hearing, the Administrative Procedure Act provides that:

“(b) *Procedure.* The agency shall afford all interested parties opportunity for (1) the submission and consideration of facts, arguments, offers of settlement, or proposals for adjustment where time, the nature of the proceeding, and the public interest permit, and (2) to the extent that the parties are unable so to determine any controversy by consent, hearing, and decision upon notice and in conformity with Sections 1006 and 1007 of this title.” 5 U.S.C. Section 1004.

Where a hearing is required under Section 1004, the Act provides that:

“(c) . . . Every party shall have the right to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. . . .

“(d) The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with Section 1007 of the title. . . .” 5 U.S.C. Section 1006.

This Court has specifically held that the Administrative Procedure Act is applicable to Department of Interior hearings relating to mining claims and entries on the public lands, see *Adams v. Witmer*, 271 Fed. 2d 29, 32-33 (9th Cir., 1959); *Stewart v. Penney*, 238 F. Supp. 821, 827 (D.C. Nev., 1965).

Moreover, in passing upon the petition, the Secretary made a decision affecting appellant's legal rights and under such circumstances the Supreme Court has said:



Thus, when governmental agencies adjudicate or make binding determinations which directly affect the legal rights of individuals, it is imperative that those agencies use the procedures which have traditionally been associated with the judicial process. *Hannah v. Larche*, 363 U.S. 420 at 442 (1960).

The primary error of the court below was caused by its erroneous belief that plaintiff's Amended Complaint did not raise any new issues not pleaded in the original Complaint (R. pp. 30-31). To the contrary, the original Complaint merely alleged that the Secretary's final decision was "arbitrary, biased and contrary to the law and fact" (R. p. 4). The original Complaint prayed for a mandatory order compelling the Secretary to approve the issuance of a patent to appellant (R. p. 5). The Amended Complaint, on the other hand, alleges that the Secretary failed and refused to hold a hearing on appellant's request for an equitable adjudication and failed and refused to exercise the discretion required of him by Section 1161 (R. pp. 8-9). Based on these new allegations, the Amended Complaint concludes with a prayer asking not only for a mandatory order compelling the Secretary to issue a patent, but, alternatively, that the Court issue a mandatory order compelling defendant Udall to hold a hearing and exercise his discretion as required by Section 1161 (R. p. 13). Thus, the second cause of action in plaintiff's Amended Complaint alleges entirely new facts and requests a different kind of relief than that prayed for originally.



**II. THE COURT BELOW HAS JURISDICTION TO ISSUE A MANDATORY ORDER DIRECTING THE SECRETARY OF INTERIOR TO PERFORM A DUTY REQUIRED BY STATUTE.**

The Court below based its decision in part upon the distinction between the ministerial and discretionary duties of government officers. It reasoned that the Courts have no jurisdiction to compel an officer to exercise a discretionary duty, but may require him to exercise a ministerial duty (R. pp. 27-29). Although this distinction has been criticized as limiting too strictly the Court's power in dealing with governmental agencies, see *Seaton v. Texas Co.*, 256 Fed. 2d 718, 723 (DC Cir. 1958), it nevertheless empowers the Court to order the Secretary to hold a hearing in the present case. As demonstrated above, Section 1161 imposes a mandatory duty upon the secretary to make an adjudication. The Amended Complaint alleges that he refused to do so. Since the obligation to hold a hearing is statutory, the Secretary has no discretion in the matter and the Courts have ample power to compel him to perform his statutory obligations. See *Manual Enterprises, Inc. v. Day*, 370 U.S. 478 (1962), requiring the Postmaster General to carry certain mail; *Greene v. McElroy*, 360 U.S. 474 (1959), requiring the Secretary of Defense to issue a security clearance; *Vitarelli v. Seaton*, 359 U.S. 535 (1959) requiring the Secretary of Interior to reinstate a federal employee.

The very cases relied upon by the Secretary in the Court below establish appellant's right to a writ of mandate in the present case. In *Larsen v. Domestic and Foreign Corporation*, 337 U.S. 682 (1949), which

held that the Court could not enjoin a government officer from disposing of war assets to plaintiff's competitor, the Court specifically held that a suit could be maintained against a government officer where he has acted "unconstitutionally" or "ultra vires his authority." 337 U.S. at 693. In *Malone v. Bowdoin*, 369 U.S. 643 (1962), which held that the plaintiff could not maintain an ejectment action against a forest service officer, the Court explained *Larsen* as follows:

"Cutting through the tangle of previous decisions, the Court [in *Larsen*] expressly postulated the rule that the action of a federal officer affecting property claimed by a plaintiff can be made the basis of a suit for specific relief against the officer as an individual only if the officer's action is '*not within the officer's statutory powers or, if within those powers, only if the powers, or their exercise in the particular case, are constitutionally void*,' 337 U.S. at 702. Since the plaintiff had not made an affirmative allegation of any relevant statutory limitation upon the Administrator's powers, and had made no claim that the Administrator's action amounted to an unconstitutional taking, the Court ruled that the suit must fail as an effort to enjoin the United States." (Emphasis added.) 369 U.S. at 647.

In the present case, it is clear that the Amended Complaint alleges that the defendant acted in excess of his statutory authority in denying plaintiff's petition for a patent without holding a hearing in conformity with the Administrative Procedure Act or 43 U.S.C. Section 1161.

Moreover, the Secretary's arbitrary denial of the petition unconstitutionally deprived plaintiff of his property without due process of law. Although the Secretary argued below that appellant could obtain judicial review of the agency action under Section 1009 of the Administrative Procedure Act (R. p. 22), review is foreclosed as a practical matter because the Secretary, by refusing to hold a hearing, has not afforded plaintiff an opportunity to make a proper record for review.

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**III. THE ADMINISTRATIVE PROCEDURE ACT PROVIDES FOR THE ISSUANCE OF A MANDATORY ORDER DIRECTING THE SECRETARY TO HOLD A HEARING.**

The Administrative Procedure Act provides that in the absence of an adequate statutory review proceeding, review may be by any applicable form of legal action “(including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus).” 5 U.S.C. 1009 (b). It further provides that the Court “shall (A) compel agency action unlawfully withheld or unreasonably delayed. . . .” 5 U.S.C. 1009 (e).

In the present case appellant has alleged that the Secretary refused to hold the hearing required by 43 U.S.C. Section 1161. This clearly states a basis for the Court to “compel agency action unlawfully withheld.”

While the Amended Complaint did not specifically allege jurisdiction under the Administrative Proce-

dure Act because the Court below had rejected this as a basis for jurisdiction in dismissing the original Complaint (R. p. 27), this omission could have been easily corrected by further amendment and should not have resulted in a dismissal of the Amended Complaint without leave to amend. As this Court has pointed out:

“leave to amend should be allowed unless the complaint ‘cannot under any conceivable state of facts be amended to state a claim.’ (citation) Leave to amend should be granted ‘if it appears at all possible that the plaintiff can correct the defect.’ 3 Moore, Federal Practice, Section 15.10 at 838 (2d Ed. 1948).” *Breier v. No. Calif. Bowling Proprietor’s Ass’n*, 316 F.2d 787, 790 (9th Cir. 1963).

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#### IV. THE DISTRICT COURT ERRED IN HOLDING THAT IT HAD NO JURISDICTION TO ORDER DEFENDANT UDALL TO ISSUE A PATENT.

The Court below concluded that it had no jurisdiction to order a patent to issue in the present case because the issuance of such a patent lies in the sole discretion of the Secretary of Interior (R. pp. 28, 30-31). Appellant respectfully submits that the Court has ample authority to direct that a patent issue in a proper case, because, although the jurisdiction of the Secretary over the public lands may be plenary, it is subject to judicial review. In *Best v. Humboldt Mining Co.*, 371 U.S. 334 (1963), the Supreme Court specifically held that a mining claimant can secure judicial review where his claims are denied and cited a case wherein the claimant sued the Secretary of

Interior individually. See 371 U.S. at 338 and Footnote 7 to the Court's opinion. As pointed out in *Stewart v. Penney*, 238 F. Supp. 821 (1965), which rejected the Secretary's claim that his finding of non-compliance with the requirements for homestead entry are binding upon the Courts:

“ ‘Thus the case really comes down to a question whether the Secretary's finding was supported by substantial evidence on the record as a whole.’ *Foster v. Seaton*, 1959, 271 F.2d 836.”

This Court reached the same conclusion in *Adams v. Witmer*, 271 F.2d 29 (9th Cir., 1959), which held that a mining claimant could maintain an action against subordinate officials of the Interior Department, specifically rejecting the government's argument that the action was not maintainable because it required “mandatory affirmative relief.” 271 F.2d at 38. A mining claimant has always had the right in a proper case to obtain a writ of mandate to compel the Land Department to issue a patent. See *Roberts v. United States ex rel. Valentine*, 176 U.S. 221 (1900); *Ballinger v. United States ex rel. Frost*, 216 U.S. 240 (1910); *Work v. United States ex rel. McAllister*, 262 U.S. 200 (1923); *Adams v. Witmer*, supra. In *Lane v. Hoglund*, 244 U.S. 174 (1916), the Secretary of Interior cancelled an *entry* upon the public lands on the basis of information from a subordinate government official that the applicant had not complied with the provisions of the Homestead Act. The Court granted a writ of mandate which compelled the Land Department to vacate the order of cancellation and directed it to issue a patent to the land. In answer



to the Secretary's assertion that the Homestead Act vested complete discretion with respect to the issuance of the patent, the Court said:

"Unless the writ of mandamus is to become practically valueless, and is to be refused even where a public officer is commanded to do a particular act by virtue of a particular statute, this writ should be granted. Every statute to some extent requires construction by the public officer whose duties may be defined therein. . . . But that does not necessarily and in all cases make the duty of the officer anything more than a purely *ministerial* one." (Emphasis added.) 244 U.S. 174, 182.

In *Cornelius v. Kessel*, 128 U.S. 456 (1888), the Court upheld the claim of the successors of a mining entrant whose entry was cancelled without notice over the claim of a subsequent party who obtained a patent from the government following the cancellation. The Court analyzed the applicant's rights as follows:

"By . . . entry and payment the purchaser secures a vested interest in the property and a right to a patent therefor, and can no more be deprived of it by order of the Commissioner than he can be deprived by such order of any other lawfully acquired property. Any attempted deprivation in that way of such interest will be corrected whenever the matter is presented so that the judiciary can act upon it." 128 U.S. at 461.

This decision was followed in a series of cases vacating the orders of the General Land Office purporting to cancel mining claims without notice or hearing. Justice Van Devanter, who was largely responsible

for the development of the law relating to claims upon the public lands (see, *Best v. Humboldt Mining Company*, 371 U.S. 334, 336 (1963)), stated the law as follows:

“A mining location which has not gone to patent is of no higher quality and no more immune from attack and investigation than are unpatented claims under the homestead and kindred laws. If valid, it gives to the claimant certain exclusive possessory rights, and so do homestead and desert claims. But no right arises from an invalid claim of any kind. All must conform to the law under which they are initiated; otherwise they would work an unlawful, private appropriation and derogation of the rights of the public.

“Of course, the Land Department has no power to strike down any claim arbitrarily, but so long as the legal title remains in the government it does have power, *after proper notice and upon adequate hearing*, to determine whether the claim is valid and, if it be found invalid, to declare it null and void. This is well illustrated in *Orchard v. Alexander*, 157 U.S. 372, where, in giving effect to a decision of the Secretary of the Interior, canceling a pre-emption claim theretofore passed to cash entry, but still unpatented, this court said:

“The party who makes proofs, which are accepted by the local land officers, and pays his money for the land, has acquired an interest of which he cannot arbitrarily be dispossessed. His interest is subject to state taxation. (Citation). The government holds the legal title in trust for him, and he may not be dispossessed of his equitable rights without due process of law. Due process in such case *implies notice and a hearing*. But this does



not require that the hearing must be in the courts, or forbid an inquiry and determination in the Land Department.' " *Cameron v. United States*, 252 U.S. 450 at 459-460 (1920). (Emphasis added.)

Under the cited cases and basic principles of constitutional law, the allegations in Paragraph 4 of plaintiff's first cause of action state a claim giving the Court below jurisdiction to issue a writ of mandate directing defendant Udall to vacate the purported cancellation of plaintiff's coal mining entry and to issue plaintiff a patent to the land involved. Moreover, the great majority of the judges of the Court of Appeals for the District of Columbia where, prior to the enactment of 28 U.S.C. § 1391(e) in 1962, most land cases were decided, have held that recent decisions, including *Larsen v. Domestic & Foreign Corp.*, 337 U.S. 682 (1949), which limited the Court's power to enjoin government officers in other contexts do not limit the use of a writ of mandate in land cases. See *West Coast Exploration Co. v. McKay*, 213 F. 2d 582 (D.C. Cir., 1954), cert. denied, 347 U.S. 989; *Clackamas County v. McKay*, 219 F. 2d 479 (D.C. Cir., 1954), cert. granted and case dismissed as moot, 349 U.S. 909; *Seaton v. Texas Co.*, 256 F. 2d 718 (D.C. Cir., 1958); *Foster v. Seaton*, 271 F. 2d 836 (D.C. Cir., 1959).

The cited cases clearly establish that the District Court has jurisdiction to issue a mandatory order requiring defendant Udall to issue a patent. Because appellant was precluded from a proper hearing before the Secretary, however, it may be that the record

would not presently support such an order. If so, the District Court should be directed to remand the controversy to the Secretary for a hearing under 43 U.S.C. Section 1161, as prayed for in the Amended Complaint.

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### CONCLUSION

For the foregoing reasons appellant respectfully submits that the District Court erred in dismissing appellant's amended complaint and the action. Appellant, therefore, requests that the Court reverse the judgment of the District Court and direct that appellant be granted a patent or that the matter be remanded to the Secretary of Interior for hearing.

Dated, San Francisco, California,

June 27, 1966.

HANSON, BRIDGETT, MARCUS & JENKINS,  
THOMAS M. JENKINS,  
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*Attorneys for Appellant.*

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### CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

THEODORE W. PHILLIPS,  
*Attorney for Appellant.*

No. 20766

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IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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SOUTHPORT LAND & COMMERCIAL COMPANY,

Appellant

v.

STEWART UDALL, AS SECRETARY OF THE INTERIOR, ET AL.,

Appellees

---

ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

---

BRIEF FOR STEWART L. UDALL, SECRETARY OF THE INTERIOR

---

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OPINION BELOW

The opinion of the district court dismissing the original complaint in this case is reported at 244 F.Supp. 2 (N.D. Cal. 1965) (R. 25-29).

JURISDICTION

The amended complaint alleged that the jurisdiction of the district court was based upon R.S. sec. 2450, 43 U.S.C.



sec. 1161 et seq., and 28 U.S.C. secs. 1331 and 1361 (R. 6). The final order of the district court was entered on November 29, 1965, dismissing the cause of action as to the Secretary of the Interior (R. 40). <sup>1/</sup> The notice of appeal was filed by Southport on December 9, 1965 (Ibid.). This Court has jurisdiction under 28 U.S.C. sec. 1291.

#### QUESTIONS PRESENTED

1. When the Secretary of the Interior is requested to make an equitable adjudication declaring the appellant entitled to a patent to certain public lands under the provisions of R.S. sec. 2450, 43 U.S.C. sec. 1161, and the Secretary concludes on the basis of admitted facts that he is precluded as a matter of law from issuing the requested patent, whether the Secretary is nevertheless compelled to hold a hearing before adjudication.

2. Whether the district court had jurisdiction to mandamus the Secretary of the Interior to issue appellant a patent under a statute which authorizes the Secretary "to

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<sup>1/</sup> Certain parties who were also defendants in this case in the lower court and are defendants-appellees in the companion case, Southport Land & Commercial Co. v. Kosanke Sand Corp., et al., No. 20767, now pending in this Court, were mining claimants whose claims were filed in 1963 and 1964 on the subject land.

decide upon principles of equity and justice" all cases of suspended entries of public lands and to adjudge in what cases patents shall issue upon the same.

3. Whether, assuming that the Secretary of the Interior cancelled a valuable interest in the public domain without a hearing in 1883, the appellant is precluded by limitations and laches from litigating in 1964 whether such cancellation unconstitutionally denied appellant a right in real property without due process of law.

#### STATUTES INVOLVED

R.S. sec. 2347 provides:

Every person above the age of twenty-one years, who is a citizen of the United States, or who has declared his intention to become such, or any association of persons severally qualified as above, shall, upon application to the register of the proper land-office, have the right to enter, by legal subdivisions, any quantity of vacant coal-lands of the United States not otherwise appropriated or reserved by competent authority, not exceeding one hundred and sixty acres to such individual person, or three hundred and twenty acres to such association, upon payment to the receiver of not less than ten dollars per acre for such lands, where the same shall be situated more than fifteen miles from any completed railroad, and not less than twenty dollars per acre for such lands as shall be within fifteen miles of such road. (30 U.S.C. sec. 71.)

R.S. sec. 2348 provides:

Any person or association of persons severally qualified, as above provided, who have opened and improved, or shall hereafter open and improve, any coal mine or mines upon the public lands, and shall be in actual possession of the same, shall be entitled to a preference-right of entry, under the preceding section, of the mines so opened and improved: Provided, That when any association of not less than four persons, severally qualified as above provided, shall have expended not less than five thousand dollars in working and improving any such mine or mines, such association may enter not exceeding six hundred and forty acres, including such mining improvements. (30 U.S.C. sec. 72.)

R.S. sec. 2349 provides:

All claims under the preceding section must be presented to the register of the proper land-district within sixty days after the date of actual possession and the commencement of improvements on the land, by the filing of a declaratory statement therefor; but when the township plat is not on file at the date of such improvement, filing must be made within sixty days from the receipt of such plat at the district office; \* \* \*. (30 U.S.C. sec. 73.)

R.S. sec. 2350 provides:

The three preceding sections shall be held to authorize only one entry by the same person or association of persons; and no association of persons any member of which shall have taken the benefit of such sections, either as an individual or as a member of any other association,

shall enter or hold any other lands under the provisions thereof; and no member of any association which shall have taken the benefit of such sections shall enter or hold any other lands under their provisions; and all persons claiming under section twenty-three hundred and forty-eight shall be required to prove their respective rights and pay for the lands filed upon within one year from the time prescribed for filing their respective claims; and upon failure to file the proper notice, or to pay for the land within the required period, the same shall be subject to entry by any other qualified applicant. (30 U.S.C. sec. 74.)

Section 37 of the Act of February 25, 1920, 41 Stat.

1, provides:

That the deposits of coal, phosphate, sodium, oil, oil shale, and gas, herein referred to, in lands valuable for such minerals, including lands and deposits described in the joint resolution entitled "Joint resolution authorizing the Secretary of the Interior to permit the continuation of coal mining operations on certain lands in Wyoming," approved August 1, 1912 (Thirty-seventh Statutes at Large, page 1346), shall be subject to disposition only in the form and manner provided in this Act, except as to valid claims existent at date of the passage of this Act and thereafter maintained in compliance with the laws under which initiated, which claims may be perfected under such laws, including discovery. (30 U.S.C. sec. 193.)



R.S. sec. 2450 provides:

The Commissioner of the General Land-Office is authorized to decide upon principles of equity and justice, as recognized in courts of equity, and in accordance with regulations to be settled by the Secretary of the [Treasury,][Interior], the Attorney-General, and the Commissioner, conjointly, consistently with such principles, all cases of suspended entries of public lands and of suspended pre-emption land-claims, and to adjudge in what cases patents shall issue upon the same. (43 U.S.C. sec. 1161.)

#### STATEMENT

Southport Land & Commercial Company, hereafter referred to as "Southport," filed this suit against the Secretary of the Interior and Steve and Beverly Kosanke in the court below on May 15, 1964 (R. 1-5). The first count of the complaint alleged that Southport had been organized as a California corporation in 1861 under the name of Black Diamond Coal Mining Company, hereafter referred to as "Black Diamond." Black Diamond acquired by quitclaim deeds whatever right, title or interest the grantors had in the N  $\frac{1}{2}$  of Section 8, T. 1 N., R. 1 E., M.D. B. & M., paying approximately \$100,000 for such interest. It was alleged that between 1861 and 1865 a total of 1,570,481 gross tons of coal was produced from the N  $\frac{1}{2}$  of Section 8 and immediately adjoining area (R. 2).

The complaint continued that Black Diamond filed  
ash Coal Entry No. 13 on April 25, 1883, with \$3,200. It  
alleged that the entry was filed as a result of the case  
Mullan v. United States."<sup>2/</sup> It was alleged that the Com-  
missioner of the General Land Office, by letter of May 7, 1883,  
cancelled the application because of the appeal of the afore-  
mentioned case to the Supreme Court. The complaint stated  
that (R. 2-3) "After the decision by the Supreme Court in  
said case, the Assistant Commissioner for the Department of  
the Interior, General Land Office, Washington, D.C. in a  
letter dated July 8, 1886, authorized the Black Diamond Coal  
Mining Company, plaintiff, to make entry, upon proper applica-  
tion, upon showing compliance with the laws regulating coal  
lands and regulations established thereunder and fixing the  
price of the land at \$20 per acre rather than \$10 amounting  
to a total of \$6,400 for the 320 acres contained in the North  
of Section 8. No record exists of the filing of said ap-  
plication and the submission of the \$6,400 nor of the return  
of the \$3,200 submitted."

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<sup>2/</sup> Mullan v. United States, 118 U.S. 271 (1886).

The complaint alleges that Southport has continued in possession during the entire period since 1886, paying state taxes and otherwise acting as if it were owner. Upon search of title subsequent to the issuance of an oil lease in 1961, the defect in legal title was discovered. As a result, Southport filed with the Bureau of Land Management a request for equitable adjudication of California Cash Coal Entry No. 13. The request was denied by a final decision dated January 15, 1964 (R. 4).

The second count of the complaint set out an independent cause of action against Beverly and Steve Kosanke under the law of the State of California, in which it was alleged that these defendants attempted to make placer and loc locations on the land involved in this case with full knowledge of Southport's rights in the land (R. 5). Since the appellee Secretary of the Interior is not concerned with this second count, it is not necessary to explore it further. This is the subject matter of case No. 20767, pending before this Court.



Insofar as the Secretary is concerned, the relief which Southport requested was that (R. 5): "\* \* \* this court issue its mandatory order compelling the defendant STEWART UDALL to approve the issuance of a patent to plaintiff for the North of Section 8, T. 1 N., R. 1 E., M.D. B. & M."

The Secretary of the Interior filed a motion to dismiss on June 16, 1965. Pursuant to this motion and subsequent arguments made and briefs filed before the district court, an order granting the motion to dismiss was entered on August 11, 1965 (R. 25-29). The order states in pertinent part as follows (R. 25-28):

\* \* \* The complaint alleges that this decision [of the Department of the Interior] was arbitrary, biased and contrary to law and fact. This conclusionary statement is apparently intended to conform to the requirement of part (e), 5 U.S.C. 1009, pertaining to the judicial review of agency action, and more specifically to the judicial scope of review. However, the relief afforded by that section is not in the nature of a mandatory court order which preempts final administrative determination. The court "shall (A) compel agency action unlawfully withheld or [un]reasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions . . ." [Emphasis by the court.] \* \* \*

Therefore plaintiff does not ask the court to review that decision, rather he seeks a hearing de novo on the merits and prays for the issuance of a mandatory order compelling the defendant Udall to approve his application for a land patent, as an original matter. The statutory language is clear. It does not impart primary jurisdiction upon this court to determine the merits of land patent claims. 43 U.S.C. 1161 et seq.

The plaintiff would then have us find legislative sanction for this suit pursuant to 28 U.S.C. 1361 which provides:

The district courts shall have original jurisdiction of any action in the nature of mandamus to compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff. [Emphasis by the court.]

\* \* \*

\* \* \* Plaintiff does not contend that a proper application for a land patent was made with the government or that any administrative error was committed by the government in relation to the land patent claim. Therefore, plaintiff has not established any duty owing to him by the government as was the case in Adams, and which is an indispensable requirement of 28 U.S.C. 1361, supra. In the absence of such duty and in the absence of any statute compelling the government to issue a land patent as a matter of course upon application from a prospective purchaser, this court cannot arbitrarily take jurisdiction.

\* \* \* \* \*

Further, the court notes that plaintiff has not named the United States as a party defendant. In and of itself, that would be fatal to this complaint, since plaintiff would have defendant Udall sign the name of the United States to a deed conveying an interest in land. \* \* \*

Thereafter Southport filed an amended complaint, which alleges in its first cause of action the same factual material down to the filing of Cash Coal Entry No. 13 (R. 6-7). It then alleges (R. 7):

Subsequently, the Commissioner of the General Land Office, by letter dated May 7, 1883, purported to cancel said entry without a hearing or prior notice to the Black Diamond Coal Mining Company. Said purported cancellation unconstitutionally deprived plaintiff's predecessor in interest of its valuable rights in and to said real property without due process of law and was void and without legal effect. Ever since said date the Commissioner of the General Land Office, and his successors, have failed and refused, and defendant STEWART UDALL does now fail and refuse to issue plaintiff or its predecessor in interest a patent by reason of said entry.

In its second cause of action, the same material relating to the acquisition of the purported title to the land is alleged as detailed above. After alleging the discovery of the defect in its title in 1961, the complaint states (R. 8-9):

On or about March 20, 1963, plaintiff filed with the Bureau of Land Management, Department of Interior, a request that it adjudge that plaintiff is entitled to a patent to said real property upon principles of justice and equity. Said request was denied by a decision dated January 15, 1964, approved by the Assistant Secretary of the Interior, which decision constituted the final administrative determination in this matter. Said decision was entered without a hearing in accordance with principles of justice and equity as required by 43 U.S.C. Section 1161 et seq., or any hearing whatsoever, and said decision was based upon secret reports, memoranda, and other evidence which defendant STEWART UDALL has refused, and does now refuse, to disclose to plaintiff and which plaintiff has had no opportunity to examine.

\* \* \* \* \*

By reason of said failure to hold a hearing and use of secret documents, STEWART UDALL has failed and refused to exercise the discretion required of him under said statutes, and has acted unconstitutionally and ultra vires his authority.

The third, fourth, and fifth causes of action relate <sup>3/</sup> to the attempt of the Kosanke interests to locate mining claim on this property and will not be developed further here.

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3/ In the amended complaint, Steve Kosanke, Beverly Kosanke, H. E. Kosanke and Kosanke Sand Corporation were named as defendants.



The Secretary of the Interior filed a motion to dismiss the amended complaint, which was granted by the district court (R. 30-31). In its order of dismissal, the court concluded that neither the first nor second causes of action state facts sufficient for a judicial review of the administrative actions of the Secretary and that neither of the causes of action presents a claim upon which relief could be granted against the Secretary, either individually or as an officer of the United States (R. 30). The present appeal is prosecuted from the denial and judgment of dismissal of the amended complaint.

#### SUMMARY OF ARGUMENT

##### I

Appellant is not entitled to a hearing under R.S. sec. 2450. The first three points of Southport's appeal rest on the argument that the district court should have ordered the Secretary of the Interior to hold an Administrative Procedure Act hearing before disposing of Southport's request that it be granted a patent. Southport argues that, since R.S. 2450 "imposes an adjudicatory function upon the Secretary," this is a "case where a statute requires an adjudication to be determined on the record after opportunity for an agency hearing

\* \* \*." But R.S. sec. 2450 does not require any hearing nor an adjudication to be determined "on the record after opportunity for an agency hearing."

The basic question is the nature of the equitable adjudication under R.S. sec. 2450. The decision of the Department of the Interior holds that as a matter of law the Secretary is without authority to grant a patent in this case. The purpose of the equitable adjudication as explained by the Supreme Court in Hawley v. Diller, 178 U.S. 476 (1900), is to authorize confirmation of entries where the law had been substantially complied with but because of some error or informality the land officers would be compelled to reject. The purpose was not to restrict the ordinary jurisdiction of land officers, but to supplement it by allowing them to apply principles of equity for saving entries from rejection or cancellation which were otherwise meritorious.

The decision of the Department of the Interior was not an adjudication on the merits of an irregular entry, but a decision that the Secretary was without authority under any

circumstances to dispose of coal lands outside the provisions of the Mineral Leasing Act of 1920, 41 Stat. 437. Section 37 of the Mineral Leasing Act of 1920 provides the only exception, namely, " \* \* \* valid claims existent on February 25, 1920, and hereafter maintained in compliance with the laws under which initiated, which claims may be perfected under such laws, \* \* \*." The Department held that cancelled Coal Cash Entry No. 13 was not a "valid claim existent on February 25, 1920," since it had been cancelled in 1883 and never thereafter perfected.

We are concerned in this case with a coal lands entry and not a mining claim. These entries do not have a continuing validity by reason of discovery and continuous possession, as mining claims. Instead, they are like entries on agricultural lands, which must be perfected as specified in the public lands laws or the entryman's rights are lost. Unless a valid application to enter is pending, the coal entryman's possession gives rise to no right worthy of recognition. To be entitled to a preferential right, the applicant must be in possession, have opened a coal mine on the land, and filed his statement



with the land office within 60 days of his actual possession or the date the lands are surveyed, whichever is later.

Since this case was disposed of as a matter of law on admitted facts, it is not necessary to decide whether a hearing in conformance with the Administrative Procedure Act is necessary. Even in judicial proceedings, the opportunity to be heard orally on questions of law is not an inherent element of procedural due process.

## II

The appellant has failed to state a claim on which relief can be granted. Appellant's substantive claim is that the district court had jurisdiction to order the Secretary of the Interior to issue a patent in this case. The mandamus jurisdiction is conferred by 28 U.S.C. sec. 1361 to compel an officer of the United States to perform a duty owed to the plaintiff. The Tenth Circuit has recently pointed out, in considering this statute, that mandamus is an extraordinary remedy which may issue only when the claim is clear and certain and the duty of the officer ministerial, plainly defined, and peremptory. "The duty sought to be exercised must be a positive

command and so plainly prescribed as to be free from doubt." Under the facts alleged in this case, there is no statute which imposes a ministerial duty on the Secretary to issue a patent. It is clear from the language of R.S. Sec. 2450 that it does not impose a positive command but, on the contrary, grants the Secretary an authority to issue patents which is discretionary. Therefore, the district court correctly held that it had no power to control or influence the judgment of an officer or to direct the performance of a discretionary duty.

Cases cited by appellant, that in the proper case the court may issue a writ of mandate directing the issue of a patent, are immaterial, since the amended complaint does not allege facts sufficient to compel the issuance of a patent to issue. Nor is it valid to argue that the present record will not support an order compelling the issuance of a patent because appellant was precluded from a proper hearing before the Secretary \* \* \*." It is not a question of whether the appellant has proved facts, but whether such facts have been

alleged in the complaint. It was assumed that all well-pleaded facts are correct when the complaint was dismissed.

### III

Insofar as there might have been error in the 1883 General Land Office proceedings, this suit is barred by laches. It may be assumed, for purposes of testing the complaint, that Southport had, on May 7, 1883, a valuable interest in the public domain which the General Land Office cancelled without hearing or prior notice. It is the Secretary's position that appellant is barred by laches from litigating the unconstitutionality of this action 81 years later in 1964. There is a general statute of limitations of six years for bringing suit against the United States. Since the relief requested is that the Secretary of the Interior convey land, the legal title to which is now admittedly in the United States, the United States is a necessary party to this suit. Therefore, the suit is barred by the statute of limitations, laches and absence of consent by the United States to be sued.

ARGUMENT

I

APPELLANT IS NOT ENTITLED TO  
A HEARING UNDER R.S. SEC. 2450

The first three points of Southport's appeal rest on the argument that the district court should have ordered the Secretary of the Interior to hold a hearing conforming to the Administrative Procedure Act, 5 U.S.C. sec. 1004 et seq., before disposing of Southport's request for a decision that it was entitled to a patent to the lands involved in this case. In the first point of its brief, pp. 4-7, Southport argues that it is obvious from the language of the statute, R.S. sec. 2450, 43 U.S.C. sec. 1161, that "it imposes an adjudicatory function upon the Secretary" (Br. 5). From this premise Southport slides without further explanation into the assumption that this case is therefore one covered by 5 U.S.C. sec. 1004: "In every case where a statute requires an adjudication to be determined on the record after opportunity for an agency hearing \* \* \*" (Br. 5). This is a glaring non sequitur. There is nothing in the language of R.S. sec. 2450, 43 U.S.C. sec. 1161, which requires any type of hearing, nor



does it require the adjudication to be determined "on the record after opportunity for an agency hearing." Southport candidly admits that it "has not been able to locate any decisions defining the type and scope of hearing required by Section 1161 \* \* \*" (Br. 4).

The problem, however, is even more basic. Before it can be determined whether the Secretary is required to hold a hearing in conformance with the Administrative Procedure Act, the nature of the equitable adjudication in this case under R.S. sec. 2450, 43 U.S.C. sec. 1161, must be determined. The decision of the Department of the Interior, which is set out as an Appendix to this brief, holds that as a matter of law the Secretary of the Interior is without authority to grant a patent in this case. The purpose of R.S. sec. 2450, 43 U.S.C. sec. 1161, was explained by the Supreme Court in Hawley v. Dille 178 U.S. 476, 493 (1900):

As carried into the Revised Statutes the purpose of this legislation is, where the law has been substantially complied with, to authorize the confirmation of entries which otherwise the land officers would be compelled to reject because of errors or informalities which, if satisfactorily explained as arising from ignorance, accident

or mistake, would, in the absence of an adverse claim, be excused by the courts, in administering the principles of equity and justice. The purpose of the legislation was not to limit or restrict the general or ordinary jurisdiction of the land officers. It was rather to supplement that jurisdiction by authorizing them to apply the principles of equity, for the purpose of saving from rejection and cancellation a class of entries deemed meritorious by Congress, but which could not be sustained and carried to patent under existing land laws. There was no necessity for legislation authorizing the rejection or cancellation of irregular entries, but legislation was necessary to save such entries from rejection and cancellation when otherwise meritorious.

The decision of the Department of the Interior in this case was not an adjudication as to the merit or lack of merit of an irregular entry.<sup>4/</sup> Instead, it was a decision that the Secretary of the Interior is without authority under any circumstances to dispose of coal lands belonging to the United States outside the provisions of the Mineral Leasing Act of 1920, 41 Stat. 437, 30 U.S.C. sec. 181 et seq. Section 37 of

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We do not overlook the antepenultimate paragraph of the Interior decision which suggests an alternative ground for granting a patent, viz., that all the coal had been mined and the land was no longer valuable for such deposits. However, this was merely "an additional point \* \* \* worthy of note," and not the basis of the decision (App. 39 ).

the Mineral Leasing Act of 1920, 41 Stat. 451, 30 U.S.C. sec. 193, provides the only exception where coal lands can be disposed of outside its provisions, namely, "\* \* \* valid claims existent on February 25, 1920, and thereafter maintained in compliance with the laws under which initiated, which claims may be perfected under such laws, including discovery." Therefore, the Secretary of the Interior disposed of this case not on the basis of any authority given in R.S. sec. 2450, 43 U.S.C. sec. 1161, but under Section 37 of the Mineral Leasing Act of 1920, supra, on the ground that the cancelled Coal Cash Entry No. 13 was not a "valid claim existent on February 25, 1920, since it had been cancelled in 1883 and never thereafter perfected. James F. Rapp, 60 I.D. 217 (1948). The Supreme Court has made it clear in Work v. Braffet, 276 U.S. 560, 566 (1928) that anything so insubstantial as a mere right to ask for an equitable adjudication under R.S. sec. 2450, 43 U.S.C. sec. 1161, on a stale entry, cancelled almost 40 years prior, could not be considered a "valid claim existent on February 25, 1920."

It must be remembered that in this case we are concerned with a coal lands entry and not a mining claim. Coal lands entries do not have a continuing validity by reason of



discovery and continuous possession as do mining claims. Instead, they are more like entries on agricultural lands, which must be perfected within the time specified by the public land laws or the entryman's rights are lost. As is stated in II Lindley on Mines (3d ed.) sec. 509, pp. 1163-1164:

It will be observed that the nature of the inchoate estate created by compliance with the coal laws bears a striking analogy to that conferred by the former agricultural pre-emption act. The same analogy exists as to proceedings to acquire the title.

The only feature in common between the coal land system and the general mining laws is, that in both discovery is required as a condition precedent to the acquisition of title.

\* \* \* \* \*

In the case of mining claims, certain prescribed work must be performed annually in order to perpetuate the estate acquired by location. A locator need never apply for a patent. Under the coal laws, no particular amount of expenditure is required, except where an association of not less than four persons seeks to enter six hundred and forty acres, it is required that they must produce proof of improvements to the extent of five thousand dollars. A patent must be applied for within a year from the filing of the declaratory statement, in case of preferential rights, under section twenty-three hundred and forty-eight of the Revised Statutes. In the case of private entries under section twenty-three hundred and forty-seven, the first step is the application for patent. [Emphasis supplied.]

Earlier in his treatise, Mr. Lindley states the steps necessary in connection with a private entry under Section 2347 of the Revised Statutes, 30 U.S.C. sec. 71, to obtain a patent. II Lindley on Mines (3d ed.) sec. 503, p. 1155. Here it is pointed out that "Until application is made to enter and purchase under this section, the claimant has no right which is worthy of recognition. His possession, if he has any, must yield to one who complies with the law and files upon the land."

The steps necessary to obtain a patent under Section 2348 of the Revised Statutes, 30 U.S.C. sec. 72, are outlined in II Lindley at Section 504, p. 1155. Two prerequisites are necessary for the preferential rights under this section:

(1) the applicant must be in actual possession of the lands applied for; and (2) he must, prior to final entry, have opened and improved mines situated thereon. If the preferential right is initiated upon surveyed lands, the claimant must present to the register of the proper land office, within 60 days after date of actual possession and commencement of improvements, his declaratory statement of facts upon which he bases his right.

Lindley on Mines (3d ed.) sec. 505, p. 1158.<sup>5/</sup> Where the lands are unsurveyed, the declaratory statement is to be filed within 60 days after the approved plat is received at the local land office (Ibid.). Failure to file this instrument within the time specified renders the land subject to entry by another, if he has complied with the land laws, but, in the absence of an adverse claimant, the right to complete the entry is not forfeited (Ibid.). After filing the declaratory statement, all persons claiming under Section 2348 of the Revised Statutes have one year to prove their rights and pay for the lands filed upon. R.S. sec. 2350, 30 U.S.C. sec. 74. Failure to pay for the land within the required period makes the land subject to entry by any other qualified applicant (Ibid.).

Since the case was disposed of as a matter of law on facts which are admitted, it is not necessary to decide whether a hearing held in conformance with the Administrative Procedure Act, supra, is necessary under either R.S. sec. 2450, 43 U.S.C. sec. 1161, or Section 37 of the Mineral Leasing Act of 1920.

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Under the mining location procedure, nothing was filed with the local office to secure possessory rights.

Clear Gravel Enterprises, Inc., 64 I.D. 210, 213 (1957). Even in a judicial proceeding, the opportunity to be heard orally on questions of law is not an inherent element of procedural due process, even where substantial questions of law are involved. Dredge Corporation v. Penny, 338 F.2d 456, 462 (C.A. 9, 1964).

This is also the answer to Points II and III of the appellant's brief. In Point II it is argued that R.S. sec. 43 U.S.C. sec. 1161, imposes the duty on the Secretary to make an adjudication, that the duty to hold a hearing before that adjudication is "statutory" and that the district court has jurisdiction to mandamus the Secretary to perform a statutory duty (Br. 8-9). Appellant does not specify which statute imposes the duty to hold the hearing before making the adjudication. We assume the reference is to the Administrative Procedure Act. However, since the case may be disposed of as a matter of law on undisputed facts without a hearing, whether or not appellant's premises that the Administrative Procedure Act imposes a statutory duty to hold a hearing on disputed issues of fact are correct becomes immaterial. Point III is



rely a variation of the same argument. The Administrative Procedure Act, 5 U.S.C. sec. 1009(e), allows the district court to "(A) compel agency action unlawfully withheld or unreasonably delayed." The brief continues (p. 10): "In the present case appellant has alleged that the Secretary refused to hold the hearing required by 43 U.S.C. Section 1161.<sup>6/</sup>" Therefore, appellant argues, the Administrative Procedure Act provides for the issuance of a mandatory order directing the Secretary to hold a hearing. But again, even assuming all of appellant's premises were correct, the district court will not order the Secretary to hold a hearing when none of the controlling facts are in dispute.

Before leaving this point, we advert to footnote 6, supra, and again remind the Court that Southport did not allege that it requested an administrative hearing from the Department of the Interior, nor does it unequivocally state in its brief

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Appellant is not correct in stating that it alleged the Secretary "refused" to hold a hearing. In fact, its allegation was that the Secretary's decision "was entered without a hearing in accordance with principles of justice and equity as required by 43 U.S.C. Section 1161 et seq., or any hearing whatever, \* \* \*" and that "By reason of said failure to hold a hearing and use of secret documents, STEWART UDALL has failed and refused to exercise the discretion required of him under said statutes. \* \* \*" [emphasis supplied] (R. 8-9).

that it requested such a hearing. Appellant is therefore precluded from raising for the first time in the district court the issue of whether it was entitled to a hearing under the Administrative Procedure Act. United States v. Tucker Truck Lines, 344 U.S. 33, 37 (1952).

This disposes of Southport's claim of error because of no hearing in the administrative proceedings. <sup>1/</sup> Let us examine its second argument before this Court.

## II

### THE APPELLANT HAS FAILED TO STATE A CLAIM ON WHICH RELIEF CAN BE GRANTED

Appellant's second claim of error, as set out in Point IV of its brief, is that the district court had jurisdiction to order the Secretary of the Interior to issue a pa in this case. Any mandamus jurisdiction which the district court had over the Secretary of the Interior is conferred by 28 U.S.C. sec. 1361, which provides that a district court has jurisdiction "of any action in the nature of mandamus" to co

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<sup>1/</sup> This case is completely distinguishable from the problems before this Court in Coleman, et al. v. United States, No. 20227 (June 21, 1966). Therefore, there is no occasion here to discuss what we believe to be the errors of the Coleman decision.

an officer of the United States to perform a duty owed to the plaintiff. In discussing the scope of this statute, the Tenth Circuit said in Prairie Band of Pottawatomie Tribe of Indians v. Hall, 355 F.2d 364, 367 (1966):

Historically, mandamus is an extraordinary remedial process awarded only in the exercise of sound judicial discretion. Before such a writ may issue, it must appear that the claim is clear and certain and the duty of the officer involved must be ministerial, plainly defined, and peremptory. \* \* \* The duty sought to be exercised must be a positive command and so plainly prescribed as to be free from doubt.  
\* \* \*

This is simply a succinct restatement of decades of decisions concerning review of adjudications relating to public and matters. In the present case, under the facts as alleged in the complaint and amended complaint there is no statute which imposes a ministerial duty on the Secretary to issue or to withhold a patent. Certainly, R.S. sec. 2450, 43 U.S.C. sec. 1161, imposes no such duty which is "a positive command and so plainly prescribed as to be free from doubt." To the contrary, it is abundantly clear from its language that R.S. sec. 2450, 43 U.S.C. sec. 1161, grants the Secretary an authority which is completely discretionary. The Supreme Court indicates the



section is discretionary, when it says the purpose of the legislation was not to limit or restrict the ordinary jurisdiction of the land officers, but to authorize them to confirm entries they would otherwise be compelled to reject. Hawley v. Diller 178 U.S. 476, 493 (1900). As to the ordinary broad powers of the Secretary of the Interior in lands matters, see Best v. Humboldt Mining Co., 371 U.S. 334, 336 et seq. (1963); Udall v. Tallman, 380 U.S. 1 (1965); Boesche v. Udall, 373 U.S. 472 (1963). Appellant would also appear to hold the same view when in paragraph VI of the second cause of action in the amended complaint, it was alleged (R. 9):

By reason of said failure to hold a hearing and use of secret documents, STEWART UDALL has failed and refused to exercise the discretion required of him under said statutes \* \* \*. [Emphasis supplied.]

The district court correctly held that it had no power to control or influence the judgment of an officer or to direct the performance of a discretionary duty (R. 27). Smith v. United States 333 F.2d 70, 72 (C.A. 10, 1964), and cases cited there.

The case cited by appellant on pages 12 and 13 of its brief, to the effect that in the proper case the court may issue a writ of mandate directing the issuance of a patent, are

material. The question is whether the amended complaint alleges facts sufficient to compel the issuance of a patent to uphold. The answer is that it does not and, as the decision of the Department of the Interior holds, the Secretary has been without authority to issue a patent in this case since February 25, 1920, regardless of the provisions of R.S. sec. 2450, U.S.C. sec. 1161. Moreover, since the issuance of a patent under the provisions of R.S. sec. 2450, 43 U.S.C. sec. 1161, is discretionary, rather than mandatory, the facts alleged in the amended complaint are not sufficient to compel the issuance of a patent, even without the statutory prohibition of Section 30 of the Mineral Leasing Act, 41 Stat. 451, as amended, 30 U.S.C. sec. 193.

Nor is it any answer that "Because appellant was precluded from a proper hearing before the Secretary, \* \* \* it may be that the record would not presently support such an order compelling the issuance of a patent]" (Br. 15-16). Again, it is not a question of whether appellant has proved facts sufficient to compel the issuance of a patent, but whether such facts have been alleged in the amended complaint. When a complaint is dismissed for failure to state a cause of action, it

is assumed that all well-pleaded facts are correct. Wyman v. Wyman, 109 F.2d 473, 474 (C.A. 9, 1940); Kohen v. H. S. Crocker Company, 260 F.2d 790, 792 (C.A. 5, 1958). It is submitted that the amended complaint pleads no facts which compel the Secretary of the Interior to issue him a patent. Under the present state of the law, it is hard to conceive of facts which could be shown to change the result. Therefore, the district court was correct in dismissing the complaint for failure to state a cause of action.

### III

INSOFAR AS THERE MIGHT HAVE BEEN  
ERROR IN THE 1883 GENERAL LAND  
OFFICE PROCEEDINGS, THIS SUIT IS  
BARRED BY LACHES

In its amended complaint, Southport alleges that the letter of May 7, 1883, which "purported to cancel said entry without a hearing or prior notice," unconstitutionally deprived it of a right in real property without due process of law. We assume, for purposes of this argument, that the well-pleaded facts, but not the conclusions of law, are correct. Therefore we may assume that Southport had, on May 7, 1883, a valuable interest in the public domain which the General Land Office

cancelled without a hearing or prior notice. The question is  
then raised whether Southport can come into court 81 years  
later in 1964 and litigate over whether this action of the  
General Land Office unconstitutionally denied Southport a right  
in real property without due process of law. It is the Secre-  
tary's position that such litigation is barred by laches,  
especially in view of the intervening legislation by which  
Congress changed the whole process of administration and dis-  
position of federal coal lands. While there is no statute  
of limitations specifically applicable to the cancellation of  
coal lands entry in 1883, the general statute of limitations  
for bringing suit against the United States in "every civil  
action" is six years. <sup>8/</sup> 28 U.S.C. sec. 2401(a). The statute  
is intended to apply to "every civil action" brought in a  
United States district court, which means all cases except a  
criminal or admiralty proceeding. Werner v. United States, 188  
F.2d 266, 268 (C.A. 9, 1951). Further, since the relief re-  
quested in this case is that the Secretary of the Interior

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The court's attention is also invited to the requirement of  
R.S. sec. 2350, 30 U.S.C. sec. 74, that all persons claiming  
under R.S. sec. 2348, 30 U.S.C. sec. 72, must prove their rights  
and pay for the land within one year from the time prescribed  
for filing their claims.



convey land, the legal title to which is now admittedly in the United States, to Southport, the United States is a necessary party to this suit. White v. Administrator of General Service Admin. of U.S., 343 F.2d 444 (C.A. 9, 1965). Therefore, insofar as this suit is to force the Secretary of the Interior to convey land belonging to the United States, it is barred not only by laches but both by the statute of limitations and by absence of any suit in which the United States has consented to be sued (Ibid.).

#### CONCLUSION

For the above reasons, the judgment of the district court is correct and should be affirmed.

Respectfully submitted,

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AUGUST 1966

**CERTIFICATE OF EXAMINATION OF RULES**

I certify that, in connection with the preparation of  
brief, I have examined Rules 18 and 19 of the United States  
Court of Appeals for the Ninth Circuit and that, in my opinion,  
foregoing brief is in full compliance with those rules.

---

A. DONALD MILEUR  
Attorney, Department of Justice  
Washington, D. C., 20530



## APPENDIX

In reply refer to:  
6.05c  
Sacramento 075330

UNITED STATES  
DEPARTMENT OF THE INTERIOR  
Bureau of Land Management  
Washington, D. C. 20240

December 10, 1963

### DECISION

Southport Land and Commercial  
Company

Request for equitable adjudication  
of California Coal Cash Entry No.

### Request Denied

The Southport Land and Commercial Company, hereinafter referred to as Southport, successor in interest of the Black Diamond Coal Mining Company, hereinafter referred to as Black Diamond, has filed a request for an equitable adjudication that it is, by virtue of Coal Entry No. 13, entitled to a patent for the N $\frac{1}{2}$  Sec. 8, T. 1 N., R. 1 E., M.D.M., in Contra Costa County, California.

The history of the N $\frac{1}{2}$  of Section 8 is thoroughly discussed in a Mineral Report prepared as a result of Southport's request for equitable adjudication. This report states, among other things, that coal was discovered and mined in the area as early as 1855, but that no formal claim was made for this tract until 1860, when the Cumberland Coal Company was formed by Francis L. Such and others to mine coal in Section 8. In June 1860 Mr. Such located the NW $\frac{1}{4}$  of Section 8 for coal under a California law dated April 20, 1852.<sup>1/</sup> In July 1860, a Mr. Noah Norton located the NE $\frac{1}{4}$  of Section 8 under the same law. According to the Mineral Report, a title search revealed that Southport's claim to the land stems from these two claims.<sup>2/</sup>

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<sup>1/</sup> The validity of this law was challenged and it is no longer effective according to the report.

<sup>2/</sup> The Report states that the chain of title from 1860 to 1867, when Black Diamond acquired its interest in the land, is not complete. It states that there are many quit claim deeds for a part interest in the land from persons who were not previously found in the chain of title, and, in many instances, there are no deeds from persons who were in the chain of title to Black Diamond.

report continues that on May 13, 1865, Frank Bernard, as an officer of Black Diamond, filed an application with the State of California to have  $N\frac{1}{2}$  of Section 8 located and sold as lieu lands under the provisions of State law of April 27, 1863.<sup>3/</sup> Location was made on June 30, 1865, for use of Bernard which was approved by the State Surveyor General on August 11, 1865. The application was never perfected, however, as Bernard failed to pay for the land.

On August 23, 1868, one John Mullan made application to the State Surveyor General for the purchase of the  $N\frac{1}{2}$  of Section 8, under the same law that Bernard had made his application. The application was accepted, and, on September 21, 1869, a Certificate of Purchase was delivered to Mullan.

Subsequently, a suit was brought by Mullan and his partner, Avery, to evict Black Diamond from the land and, still later, a separate damage suit was brought by Mullan and Avery for damages for the coal Black Diamond had mined on the land. As a result, Black Diamond sought, through the Attorney General's office, to have the State selection set aside. The matter was ultimately decided in favor of Black Diamond by the Supreme Court of the United States.<sup>4/</sup> The Court held that coal lands are mineral lands within the meaning of that phrase as used in the statutes regulating the disposition of the public domain and that the State of California could not, under the provisions of Section 7 of the act of March 3, 1853 (10 Stat. 244), select coal lands. It held that the selection and listing of known coal lands could be set aside in a suit for equity brought by the United States, which would vacate the title of the land and of those claiming under it.

A Coal Entry No. 13 was filed by Black Diamond, under Sections 2347 through 2349, Revised Statutes (30 U.S.C.A. 71 et seq.), on April 25, 1883, at which time \$3,200, \$10 per acre for the 320 tract, was submitted. The application was rejected and cancelled by the Commissioner of the General Land Office on July 7, 1883, because the Mullan case, supra, was still pending before the Supreme Court. Subsequently, in a letter dated July 8, 1886, the Assistant Commissioner of the General Land Office informed the Register and Receiver at San Francisco that Black Diamond should be allowed to make entry "upon proper application and showing compliance with the laws regulating the sale of coal lands and the regulations established thereunder." (Emphasis added.) He told the Register and Receiver that the purchase price of the land would be \$20 per acre, not \$10, because the land was within 15 miles of a completed road, but that this amount would have to be paid in full by Black Diamond.

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The law was titled "An act to provide for the sale of certain lands belonging to the State," and was issued under the authority of the act of March 3, 1853 (10 Stat. 244), which provides for in lieu selections of public lands by States.



as a credit could not be allowed for the \$3,200 previously submitted. He stated that Black Diamond could make application for a repayment of the \$3, previously submitted. 5/ He also told the Register and Receiver that Black Diamond would have to file a certified list of its stockholders showing the capacity of each to enter the land. Black Diamond did not, however, file another application, request that its application of April 25, 1883, be recognized, or take any other action toward the perfection of the entry within the one year period prescribed by law. 6/

The Mineral Report states that in 1887 the N $\frac{1}{2}$  of Section 8 was sold to the State of California for delinquent taxes for the years 1886 and 1887. In 1890 the Southport Land and Commercial Company was formed as a subsidiary of Black Diamond. Shortly after its organization, Southport bought from Black Diamond the N $\frac{1}{2}$  of Section 8 and other lands, obtaining a quit claim deed from Black Diamond for the lands. Later, in June 1900, Southport redeemed the N $\frac{1}{2}$  of Section 8.

In 1959 Black Diamond absorbed its subsidiary and adopted its name.

Southport and its predecessor, Black Diamond, were in undisputed possession of the land from at least 1886 to 1961, except for the short time it was sold to the State for delinquent taxes, and have paid all local tax assessments since 1900. Officers of Southport have stated that their Company was under the impression that a patent had been issued for the N $\frac{1}{2}$  of Section 8 years ago, and that they did not know it was public land until told so by the Shell Oil Company in 1961.

Southport now seeks an equitable adjudication that it is entitled to a patent to the N $\frac{1}{2}$  of Section 8 pursuant to the provisions of 43 U.S.C. 1161 through 1163, and the pertinent regulations issued by the Department of the Interior, 43 CFR Part 107. 7/

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5/ There is no record that a refund was either requested or made.

6/ The law reads, in part, as follows:

"\* \* \* all persons claiming under section 72 of this title shall be required to prove their respective rights and pay for the lands filed upon within one year from the time prescribed for filing their respective claims; and upon failure to file the proper notice, or to pay for the land within the required period, the same shall be subject to entry by any other qualified applicant." (30 U.S.C.A. 74).

7/ 43 U.S.C. 1161 provides:

"The Secretary of the Interior, or such officer as he may designate, is authorized to decide upon principles of equity and justice, as recognized in courts of equity, and in accordance with regulations to be approved by the Secretary of the Interior, consistently with such principles, all cases of suspended entries of public lands and

Leasing Act of February 25, 1920 (41 Stat. 437; <sup>30</sup> ~~43~~ U.S.C.A. 181 et seq.) prizes the disposition of certain classes of mineral lands of the United States, including coal lands, by the Secretary of the Interior only by lease. Under the Leasing Act, coal lands of the United States were subject to disposition by the Secretary only by lease 'except under section 37 as to claims existing at date of the passage of this Act and thereafter obtained in compliance with the laws under which initiated, which claims were perfected under such laws, including discovery.' Work v. Braffett, U.S. 560, 564 (1928).

In the instant case, it is our opinion that Coal Cash Entry No. 13 was not valid claim existent at the date of the Leasing Act of February 25, 1920, as it had been cancelled outright by the Commissioner of the General Land Office on May 7, 1883, and never thereafter perfected. The Secretary of the Interior is, therefore, precluded by the Leasing Act from reinstating or giving favorable consideration to the Entry. Section 37 of the Act contains the only exception to its operation as wholly superseding the operation of the prior law.<sup>8/</sup>

Additional point is worthy of note here. The Mineral Report states that in 1886 most, if not all, of the coal had been mined from the N $\frac{1}{2}$  of Section 8. Assuming this to be so, even at the time Black Diamond was invited to submit application for entry under the coal laws the land was no longer valuable for such deposits.<sup>9/</sup> Thus, the claim could not have been perfected in compliance with the coal laws.

Accordingly, Southport's request for a patent to the N $\frac{1}{2}$  Sec. 8, T. 1 N., R. 1 E., M.D.M. is denied.

This decision is the final administrative determination in this matter.

Charles H. Stoddard  
Director

Approved: January 15, 1964

*W. O. Carson*  
Assistant Secretary of the Interior

It should be noted that Section 2 of the Leasing Act authorizes the Secretary of the Interior to recognize and consider the equitable rights of those who have, in good faith, improved and occupied or claimed coal lands, but only in connection with the issuance of coal leases.

lands to be subject to disposition under the coal land laws, lands had to contain 'workable' deposits; that is, coal in such quantity and of such quality as would warrant a prudent coal miner or operator in the expenditure of money and labor incident to the opening and operation of a coal mine or the use of the land on a commercial basis." Samuel D. Bulford et al. 451 U.S. 404, 400



No. 20,766

IN THE

United States Court of Appeals  
For the Ninth Circuit

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OUTHPORT LAND & COMMERCIAL COMPANY,  
*Appellant,*

VS.

STEWART UDALL, as Secretary of the Interior,  
*Appellee.*

On Appeal from the United States District Court  
for the Northern District of California,  
Southern Division

APPELLANT'S REPLY BRIEF

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WM. B. LUCK, CLERK

FEB 14 1967





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On Appeal from the United States District Court  
for the Northern District of California,  
Southern Division

**APPELLANT'S REPLY BRIEF**

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**ARGUMENT**

**I.**

THE SECRETARY'S ADJUDICATION UNDER R.S. SEC. 2450  
MUST CONFORM TO THE PROCEDURAL REQUIREMENTS  
OF THE ADMINISTRATIVE PROCEDURE ACT AND APPEL-  
LANT IS ENTITLED TO AN AGENCY HEARING.

The issue on this appeal is most clearly joined by  
the Secretary of Interior's bald assertion that

“There is nothing in the language of R.S. Sec.  
2450, 43 U.S.C. Sec. 1161, which requires *any* type  
of hearing, *nor does it require the adjudication to  
be determined ‘on the record after opportunity  
for an agency hearing.’*” (Br. 19, 20, emphasis  
added.)

Appellant submits that R.S. Sec. 2450 was enacted by a legislature that understood the meaning of words; that when it commanded the Secretary to decide “*upon principles of equity and justice, as recognized in courts of equity*” it required him to conform to procedures traditionally associated with the judicial process; and that the statute clearly precludes the arbitrary kind of decision-making which the Secretary employed here.

While the Secretary has argued that it is a “glaring non-sequitur” (Br. 19) to assume that because an agency adjudicates, it must comply with the provisions of the Administrative Procedure Act, 5 U.S.C. Sec. 1001, et seq. appellant submits that this is precisely what the law requires. In *Wong Yong Sung v. McGrath*, 339 U.S. 33 (1950), the Court held the Act applicable to hearings in deportation cases even though the deportation statute involved, 39 Stat. 874, 889, as amended, 8 U.S.C. Sec. 155(a), did not require either a hearing or an adjudication. See 339 U.S. at pp. 48, 50-51. Justice Jackson, speaking for the Court, outlined the administrative abuses that preceded the Act and the inherent ambiguity in Sec. 5 of the Act, 5 U.S.C. Sec. 1004, insofar as it applies “In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing.” After discussing the government contention that this limited the Act’s application to situations when “explicit statutory words granting a right to adjudication can be pointed out” (339 U.S. at 54), the Court held that the quoted section exempted from its application

“only those hearings which administrative agencies may hold by regulation, rule, custom, or special dispensation; not those held by compulsion. We do not think the limiting words render the [Act] inapplicable to hearings, the requirements for which have been read into a statute by the Court in order to save the statute from invalidity.” 339 U.S. at 50.

Thus, even the government’s argument in the *McGrath* case, *supra*, *conceded* that the Act, including the hearing requirement of 5 U.S.C. Sec. 1006, applied where the statute granted a right to an agency *adjudication*. Yet, in the present case the Secretary has attempted to persuade this Court that when he adjudicates under R.S. Sec. 2450, he is somehow exempt from following the established procedures of the Administrative Procedure Act.

In *Hannah v. Larche*, 363 U.S. 420 (1960), the Court held that the rules of procedure adopted by the Civil Rights Commission in connection with investigation of alleged Negro voting deprivation were constitutional although they did not provide for cross-examination of complaining witnesses by the voting registrars against whom complaints had been made. In doing so, however, the Court emphasized that the Commission was merely an investigative agency without power to adjudicate or make any determination which would affect a person’s legal rights. 363 U.S. 440-441. The Court contrasted the Commission’s investigatory function with administrative agencies performing quasi-judicial functions, which, it stated,



were bound by the requirements of the Administrative Procedure Act. 363 U.S. at 445, 451-453.

In essence, then, the Supreme Court has established a functional analysis to determine when an agency is required to conform to the procedural requirements of 5 U.S.C. Secs. 1004 and 1006.

Appellant submits that it would be difficult to imagine a statute more clearly prescribing an adjudicatory, quasi-judicial, function than R.S. Sec. 2450.

The Secretary also argues that since the Secretary disposed of the instant case on a matter of law, it was unnecessary to hold a hearing (Br. 25-26). While it may be true that a trial type hearing, including the opportunity to present evidence and examine witnesses, is not required where there are no disputed facts, in such a case traditional notions of justice require an opportunity to present written and oral argument. See *Producers Livestock Marketing Assn. v. United States*, 241 F.2d 192, 196 (10th Cir. 1957), cited with approval in Davis, *Administrative Law Treatise*, Sec. 701; and *Railroad & Warehouse Commission v. Chicago N.W. Ry.*, 256 Minnesota 227, 98 N.W.2d 60 (1959), which held that such a right is an element of due process. See also *Dredge Corporation v. Penney*, 338 F.2d 456 (1964), which required an opportunity for oral argument upon motion for summary judgment in the District of Nevada and which neither rested upon nor disclaimed the due process clause as a basis for the decision.

Moreover, an alternate basis for the Secretary's decision in this case is that the secret mineral report

(referred to in appellant's amended complaint) (R. 9) indicates that the land was not subject to entry in 1883 because all of the coal deposits had already been removed. (See Appendix to Appellee's Brief, p. 39.) This is clearly a factual determination upon which appellant is entitled to present evidence and cross-examine witnesses in a trial type hearing.

The inherent danger of an agency determination without a hearing is demonstrated in this case. The Secretary argues (Br. 21-22) that he could not adjudicate appellant's claim because the Mineral Leasing Act of 1920, 41 Stat. 437, 30 U.S.C. Sec. 181 et seq. provides the exclusive means of disposing of coal lands. He concedes, however, that there is an exception for suspended entries (Br. p. 22), but states that appellant has no such entry because it was cancelled in 1883.

The amended complaint alleges, and the truth is, that the Commissioner of the General Land Office purported to cancel appellant's entry in 1883. The purported cancellation, however, was a void act without legal effect because it was done without notice or hearing.

An entry upon the public lands, whether under the homestead or mining laws, is a valuable property right which gives the entrant a vested interest in the land which cannot be cancelled except after notice and hearing. *Cameron v. United States*, 252 U.S. 450 (1920); *Lane v. Hoglund*, 244 U.S. 174 (1916); *Orchard v. Alexander*, 157 U.S. 372 (1894); *Cornelius v. Kessel*, 128 U.S. 456 (1888). This Court only recently summarized the rights of an entryman in another case where the Secretary sought to preclude effective review:

“It has long been established that a qualified entryman upon public lands of the United States, whether as a locator of a mining claim, as a homesteader, or as one asserting rights under other of the multifarious laws governing entries on public lands, who perfects his entry by compliance with the applicable Act of Congress, thereby acquires a right to the land as against the sovereign itself, as well as third persons. *Wilbur v. Krushnic*, 1930, 280 U.S. 306. It is such a legal right which appellant here seeks to assert, and it is not a right which the Secretary of the Interior may, in his discretion, ignore or which he may reject ‘in the absence of fraud or imposition.’ This is precisely the kind of right which the Administrative Procedure Act, with its provisions for judicial review, was designed to safeguard from arbitrary, capricious and illegal deprivation by action of executive and administrative agencies. *Adams v. Witmer* (9 CCA 1959), 271 F 2d 29.”

*Coleman v. United States*, 363 F.2d 190, 196 (9th Cir. 1966).

Thus, appellant has a suspended entry which is specifically exempted from the provisions of the Mineral Leasing Act and which is subject to adjudication under R.S. 2450. The Secretary's failure to afford appellant an agency hearing, however, precluded his consideration of these points.

In the Court below, the Secretary coupled his argument that R.S. 2450 does not require a hearing with the equally shocking proposition that the Court lacked power to review his action because his discretion is

absolute.<sup>1</sup> Although that argument appears to be abandoned on this appeal, it was the argument upon which the District Court based its decision.<sup>2</sup>

Thus, the Secretary appears to argue that (1) his discretion to issue a patent under R.S. Sec. 2450 is absolute, (2) the federal courts have no power to review his decisions, and (3) the federal courts have no power to compel him to hold a hearing before he exercises his absolute discretion. Appellant respectfully submits that to state such an argument is to reject it as unworthy of consideration. Moreover, this Circuit has held that the Administrative Procedure Act is applicable to proceedings related to mining claims and provides a basis for judicial review of agency action. *Adams v. Witmer*, 271 F.2d 29, 32-33 (9th Cir. 1959); *Stewart v. Penney*, 238 F. Supp. 821, 827 (D.C. Nev. 1965). A decision of this Court announced since the filing of the opening brief states that:

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<sup>1</sup>In his memorandum of points and authorities in support of the motion to dismiss appellant's amended complaint, appellee argued: "This Court is without power to direct the retraction or reversal of the action taken by the Bureau of Land Management in its final decision dated January 15, 1964, denying plaintiff a mineral patent. *Wilbur v. United States*, 281 U.S. 206 at 218. Nor may this Court, by mandate, order the defendant Secretary to hold a hearing and exercise his discretion . . ." (R. 22.)

<sup>2</sup>The Order and Judgment of the District Court (R. 30, 31) indicate two grounds for the Court's decision: (1) Failure to state a claim upon which relief could be granted because the matters complained of lie within the sole discretion of the Secretary and, (2) All of the issues pleaded were before the Court in the original complaint which was dismissed for reasons set forth in the Court's memorandum opinion dated August 10, 1965. (Reported at 244 F. Supp. 172.)

“We think it settled, at least in this Circuit, that although the Administrative Procedure Act does not permit a trial *de novo* of administrative decisions (citations) it does authorize and require judicial review under the Administrative Procedure Act . . .” *Coleman v. United States*, 363 F.2d 190, 193 (9th Cir. 1966).

On the basis of the cited authorities, we believe it clear that appellant is entitled to an agency hearing in this case. It is equally clear that the District Court has power to direct the Secretary to hold such a hearing. As pointed out above, this Circuit has held the Administrative Procedure Act applicable to the Department of Interior and Section 10 of the Act, 5 U.S.C. Sec. 1009, specifically provides that the Court may compel agency action unlawfully withheld.

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## II.

### THE DISTRICT COURT HAS JURISDICTION TO ORDER THAT A PATENT ISSUE.

The Secretary argued in the District Court that it had no jurisdiction to order that a patent issue because the issuance of a patent lies within the absolute discretion of the Secretary. The Court so ruled. On appeal, however, his position has changed and it now appears that he concedes that where the right to a patent is clear, the Court may order its issuance. (Br. p. 28.) As stated in appellant's opening brief, the Secretary's failure to afford it an opportunity to present evidence and make a record may preclude the issuance of a writ at this time because there are no



facts before the Court from which it can determine whether there is a clear duty owed to appellant here.

The authority granted to the Secretary under R.S. 2450 is not, however, "completely discretionary" as he has argued here. (Br. 29.) As pointed out in the first section in this brief, the Secretary is required to conform to procedures traditionally associated with the judicial process. Moreover, his determination is subject to the same standard of review as other agency decisions. It must be supported by substantial evidence and not arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. Sec. 1009.

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### III

#### **APPELLANT'S CLAIM IS NOT BARRED BY LACHES.**

The Secretary's last point is that this action is barred by laches since appellant's entry was cancelled in 1883. While this argument may have superficial appeal, it is clear that this action is not barred by the facts pleaded in the amended complaint.

Under California law a cause of action relating to real property does not accrue as to the party in possession of the land until he has notice of a hostile claim. *Tannhauser v. Adams*, 31 C.2d 169, 175 (1947); *McKenna v. Payne*, 105 C.A.2d 752 (1951); *Security Realization Company v. Henderson*, 120 F.2d 449 (9th Cir. 1941) (applying the same rule to personal property).

Paragraph III of appellant's Second Cause of Action alleges continuous possession of the property.



(R. 8.) Paragraph IV (R. 8) alleges that appellant believed in good faith that it was the lawful owner of the property in question since 1883 and did not discover the defect in its title until 1961.

This allegation, together with other allegations setting forth the money spent to improve the land, the taxes paid, and its redemption at a tax sale, rule out the defense of laches. The general rule is that the doctrine does not apply absent *inexcusable* delay and *prejudice* to the defendant. See *Holmberg v. Armbright*, 327 U.S. 392, 395 (1946).

In the present case it is clear that appellant did not sleep on its rights because it was unaware of the defect in its title until 1961. Thereafter, it acted with reasonable diligence in requesting an equitable adjudication in 1963.

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### CONCLUSION

On the basis of the authorities cited herein and in appellant's opening brief, appellant respectfully requests that the Court reverse the judgment below and direct that appellant be granted a patent or that the matter be remanded to the Secretary of Interior for hearing.

Dated, San Francisco, California,  
November 1, 1966.

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THOMAS M. JENKINS,  
THEODORE W. PHILLIPS,  
*Attorneys for Appellant.*

No. 20,781✓

**United States Court of Appeals  
For the Ninth Circuit**

RETAIL CLERKS UNION, LOCAL NO. 1179,  
RETAIL CLERKS INTERNATIONAL ASSO-  
CIATION, AFL-CIO,

*Petitioner,*

VS.

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

**On Petition to Review, Modify and Set Aside an Order  
of the National Labor Relations Board**

**BRIEF FOR PETITIONER**

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**FILED**

**FEB 14 1967**

**JUN 21 1968**

WM. B. LUCK, CLERK



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No. 20,781

**United States Court of Appeals  
For the Ninth Circuit**

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RETAIL CLERKS UNION, LOCAL NO. 1179,  
RETAIL CLERKS INTERNATIONAL ASSO-  
CIATION, AFL-CIO,

*Petitioner,*

vs.

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

**On Petition to Review, Modify and Set Aside an Order  
of the National Labor Relations Board**

**BRIEF FOR PETITIONER**

---

**JURISDICTION**

This is a proceeding to review, modify, and set aside an order of the National Labor Relations Board dismissing a complaint filed pursuant to the provisions of the Labor-Management Relations Act (29 U.S.C. § 151, et seq.). This Court's jurisdiction rests upon 29 U.S.C. § 160(f), and is admitted by Respondent's Answer.

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**STATEMENT OF THE CASE**

On or about September 16, 1964, the Petitioner herein, Retail Clerks Union, Local No. 1179, com-



menced picketing the employer, John P. Serpa, Inc.'s, auto sales location in Martinez, California (R. Vol. 1-A, p. 121) for the purpose of informing the public that the employer did not have a collective bargaining agreement with Petitioner and to organize the employer's auto salesmen (R. Vol. 1-B, p. 143). Shortly after the picketing commenced, the employer's general manager and half owner, Mr. Fred Peri, was informed by a business representative of the Petitioner that attempts were being made by Petitioner to organize the sales personnel (R. Vol. 1-B, p. 143). In consequence of that announcement, Peri had several meetings and conferences with representatives of the Contra Costa Automotive Association, Inc. (herein the "Association"), an employer collective bargaining representative dealing with several other unions representing employees in an association-wide bargaining unit.<sup>1</sup> These meetings concerned the meaning and purposes of the picketing and the possible development of union organization of the employer's auto salesmen (R. Vol. 1-B, pp. 169, 170).

Petitioner union succeeded in securing authorization cards from five of the employer's seven auto salesmen. These cards gave Petitioner the right to represent the salesmen in collective bargaining with the employer (R. Vol. 1-A, pp. 53-57). Upon receipt of this written evidence of the desires of the majority of the auto salesmen for collective bargaining representation by

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<sup>1</sup>John P. Serpa, Inc. is a member of the Association, although its sales personnel are not among those employees covered by agreements between those various unions and the Association. (R. Vol. 1-A, p. 10.)

the Petitioner, three officials of the Petitioner, on September 25, 1964, visited Peri, the general manager, in his office for the express purpose of demanding recognition of the Petitioner as the collective bargaining representative of the auto salesmen. At this meeting with the general manager, who, incidentally, is in charge of labor relations for the employer (R. Vol. 1-A, pp. 13, 51), the Petitioner, through its secretary-treasurer, Mr. William Roddick, presented Peri with a letter demanding recognition together with a recognition agreement for Peri's signature on behalf of the employer.

Mr. Peri read the documents and asked Roddick their meaning (R. Vol. 1-A, pp. 16, 17, 22). Roddick explained that the Petitioner represented the employer's auto salesmen and requested that the employer therefore recognize Petitioner for collective bargaining purposes (R. Vol. 1-A, p. 22). Roddick asked Peri how many salesmen were employed by the employer at its Martinez and Concord, California, locations and Peri replied that there were seven such employees. Roddick then presented Peri with the authorization cards signed by five of these salesmen. These cards were carefully examined by Peri, and Peri admitted that from his examination of the cards he knew that they contained signatures of his five salesmen other than salesmen Freitas and Davis (R. Vol. 1-A, p. 18, Vol. 1-B, p. 158). Roddick at first suggested that a card cross-check be utilized by the parties as a means of ascertaining whether Petitioner in fact represented the employer's salesmen (R. Vol. 1-A, pp. 27, 28), but

later stated that this procedure was not necessary in view of the fact that Peri himself had examined the cards and had not expressed any doubts as to the validity of the cards as evidence of the Petitioner's majority status (R. Vol. 1-A, p. 29).

As Peri himself testified during the hearing before the National Labor Relations Board's Trial Examiner: "The cards were right there for me to look at them, if I wanted to." (R. Vol. 1-A, p. 29, lines 3-4), and, of course, Peri admitted that he had in fact examined the cards and therefore knew that only Freitas and Davis had not signed cards (R. Vol. 1-B, p. 158). The evidence adduced at the hearing is clear that Peri expressed no doubt whatsoever that the Petitioner represented a majority of the employer's auto salesmen. Peri stated: "What comment could I make?" (R. Vol. 1-A, p. 23, line 10. See also Vol. 1-A, p. 36). After examining the cards and reading the letter demanding recognition and the recognition agreement, Peri informed the Petitioner's representatives that he would like to consult with his attorney and would thereafter telephone Roddick and let him know what the employer intended to do (R. Vol. 1-A, pp. 60, 80, 81, 86).<sup>2</sup> Roddick left his business card with Peri, after writing on it his home telephone, so that Peri could contact him over the week-end (R. Vol. 1-A, p. 24).

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<sup>2</sup>The Trial Examiner of the National Labor Relations Board credited the Petitioner's testimony that Peri promised to call the Union officials as soon as he had contacted his attorney. (R. Vol. 1, p. 16.)

Although Peri contacted his attorney the following day (R. Vol. 1-A, p. 24), he did not telephone or otherwise contact any of the Union representatives. On the contrary, in the words of the National Labor Relations Board's Trial Examiner, who later heard the case:

... but from all the record divulges the Respondent did nothing at all. Peri apparently clung to the hope that the Union would just go away. (R. Vol. 1, p. 16.)

Moreover, Peri made no effort after the meeting with the Petitioner's representatives to question his salesmen or otherwise raise any question as to the validity of the cards or as to whether the cards in fact accurately represented his employees' desires as to representation by Petitioner (R. Vol. 1-A, p. 29).

Peri's state of mind is further evidenced by the fact that when one of Petitioner's business representatives contacted Peri again on October 1, 1964 at the employer's premises (R. Vol. 1-A, p. 73), Peri informed the Union official that he would *never* sign a recognition agreement with Petitioner (R. Vol. 1-A, p. 74). Not having heard from Peri, Petitioner on September 29 filed with the National Labor Relations Board a written Charge against the employer alleging that the employer violated the National Labor Relations Act, as amended, by its refusal to recognize and bargain with the Petitioner (R. Vol. 1, p. 34).

The Board, on December 21, 1964, after a complete and thorough investigation by its Regional Office of the facts of the Charge, issued a Complaint based upon

the Charge (R. Vol. 1, p. 5), and a hearing was held before a Trial Examiner of the Board. Testimony ad-  
duced at the Board proceedings reflected, without  
direct refutation, a substantial amount of coercive  
conduct by the employer's agents and representatives  
directed against members of the Petitioner engaged  
in the picketing of the employer's premises (R. Vol.  
1-A, pp. 110-128). The testimony relating to this  
conduct will be brought out in more detail in the argu-  
ment herein.

The Board's Trial Examiner, who observed the de-  
meanor of all of the principals on the witness stand  
and who passed upon the issue of credibility in each  
case, found that *the employer did not have a good  
faith doubt of the Petitioner's majority status at the  
time of Petitioner's demand for recognition on Sep-  
tember 25, 1964* (R. Vol. 1, p. 16). The Trial Ex-  
aminer went on to find, however, that because two of  
the five salesmen later signified to the employer their  
repudiation of the Petitioner, the employer should not  
be required to recognize and bargain with the Peti-  
tioner on the basis of such "a fleeting and evanescent  
majority" (R. Vol. 1, p. 16).<sup>3</sup> The Trial Examiner con-  
sequently recommended dismissal of the Complaint.

Upon a review of exceptions to the decision of the  
Trial Examiner, filed by the General Counsel of the  
Board and by the Petitioner, as charging party, the

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<sup>3</sup>The Union was never advised of this purported "repudiation"  
until late October (R. Vol. 1-A, p. 101). Such "repudiation" has  
no relevance to the Employer's earlier refusal to bargain. See  
*Country Lane Food Store*, 142 NLRB 683, 696; *Snow v. NLRB*,  
308 F. 2d 687 (9th Cir. 1962).



Board affirmed the Trial Examiner's ultimate conclusion that the Complaint should be dismissed (R. Vol. 1, p. 24). The Board thereupon dismissed the Complaint. However, in so doing, the Board adopted an entirely different ground for its decision from the rationale utilized by the Trial Examiner, i.e., the Petitioner's "fleeting and evanescent majority". Instead, the Board determined that the General Counsel had produced no evidence indicating that the employer did not act in good faith when it refused to recognize and bargain with Petitioner or indicating that the employer had rejected the collective bargaining principle manifested in the Act. In so doing, the Board attempted to distinguish its decision in *Snow & Sons*, 134 NLRB 709, *enf'd* 308 F. 2d 687 (9th Cir. 1962) on grounds hereinafter discussed.

This petition to review, modify and set aside the Board's order dismissing the Complaint followed.

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#### QUESTION INVOLVED

Is there substantial evidence in this Record to support the Board's finding—which is contrary to the finding of the Trial Examiner who heard the case—that the employer had a good faith doubt as to Petitioner's majority status?



**ARGUMENT**

The primary issue in this case, for review by this Court, is whether or not the employer, John P. Serpa, Inc., entertained at the time of the request for recognition, a *bona fide* doubt concerning the Petitioner's status as representative of the majority of the employer's auto salesmen. If the employer in fact had no good faith doubt of the Petitioner's majority status, it is guilty of a refusal to bargain with Petitioner within the meaning of Section 8(a)(5) of the Act, *Snow & Sons*, 134 NLRB 709, *enf'd* 308 F. 2d 687 (9th Cir. 1962); *Kellogg's Inc., d/b/a Kellogg Mills*, 147 NLRB No. 41, *enf'd* 347 F. 2d 219 (9th Cir. 1965), and the order of the Board dismissing the Complaint herein is erroneous and should be set aside.

The issue thus turns upon a question of fact: Was the employer motivated by a good faith doubt as to the Petitioner's majority status when it refused to recognize and bargain with the Petitioner at the time of the presentment to it on September 25, 1964 of the authorization cards signed by five of the seven auto salesmen? With respect to the review of this question of fact, this Court in *Snow & Sons*, *supra*, properly stated its function upon review to be:

The findings of the Board with respect to this question of fact, if supported by substantial evidence on the record considered as a whole, are conclusive. Section 10(e) of the Act, 29 U.S.C.A. § 160(e). But unlike the rule which obtains on the review of the sufficiency of the evidence to support a jury verdict, the substantiality of the evidence in support of the Board's findings "must take into account whatever in the record fairly

detracts from its weight". *Universal Camera Corporation v. NLRB*, 340 U. S. 474, 488, 71 S. Ct. 456, 95 L. Ed. 456.

...

... the Supreme Court has admonished that evidence supporting a conclusion reached by the Board "... may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion" *Universal Camera Corporation* at pages 492, 496, 71 S. Ct. at pages 467, 468.

*Snow & Sons*, 308 F. 2d at page 691.

The Trial Examiner's conclusion is clear in his decision on this question of fact. He determined that the employer had *no* good faith doubt of the Petitioner's majority status on September 25, 1964, the date of the Petitioner's presentment to the employer of the authorization cards signed by a majority of the auto salesmen and the date of Petitioner's demand for recognition as their collective bargaining representative (R. Vol. 1, pp. 15 and 16). The Board, on the other hand, upon review, rested its order dismissing the Complaint upon the ground that *no evidence* was introduced to show the absence of good faith doubt on the part of the employer when it refused, on September 25, 1964, to recognize and bargain with the Petitioner as the representative of its auto salesmen.

As to the Trial Examiner's conclusion concerning the Union's "fleeting and evanescent" majority, it

cannot be gainsaid that if the Board had given its attention to this matter instead of concerning itself with the Trial Examiner's findings of fact, the Board would have rejected this conclusion as contrary to the decisions of the Board and the Courts. The fact as to whether an employer entertained a genuine doubt that a union represents a majority of the employees is to be determined by precise reference to the time of the refusal to recognize and bargain with the Union. *United Mine Workers v. Arkansas Oak Flooring Co.*, 351 U. S. 62, 74 (1956); *Snow & Sons*, supra; *Franks Bros. v. NLRB*, 321 U. S. 702 (1944); *Scobell Chemical Co. v. NLRB*, 267 F. 2d 922 (2nd Cir. 1959); *Henry Spen & Co.*, 150 NLRB No. 21.

In the present case, it is manifest that the employer refused to bargain on the date of September 25, 1964 when it refused to recognize Petitioner as bargaining representative even though it had no doubt whatsoever as to the fact that Petitioner represented a majority of the employees in the appropriate unit. Even if it had been found by the Board's Trial Examiner that the employer's refusal to bargain did not occur until October 1, 1964, when the employer's agent orally and unequivocally stated that he would *never* sign an agreement recognizing the Petitioner as the representative of the auto salesmen, it is nevertheless apparent that the alleged repudiations were not a factor in the employer's decision not to recognize the Petitioner's majority status. Thus, the employer readily admitted that the purported written statements from two of its salesmen repudiating the Petitioner as their

representative had no bearing whatever on its decision not to recognize the Petitioner (R. Vol. 1-B, pp. 159-160). Such statements therefore, are completely immaterial to the refusal to bargain issue.

The true focal point of this case is whether or not there is sufficient evidence to support the Trial Examiner's finding of fact that the employer actually entertained no genuine doubt of the Petitioner's majority status at the time of the employer's refusal to recognize and bargain with the Union.

The Petitioner presented its demand for recognition in clear, simple, and unequivocal terms, orally and by letter and, at the employer's request, further explained its majority designation and that the unit sought was limited to the seven auto salesmen. Cards signed by five of the seven salesmen were submitted to the employer, who personally examined them. The employer then and there conceded that these cards showed representation by the Union of a majority of the employees in the unit. The employer neither challenged the authenticity of the signatures nor the validity of the cards, expressed no doubt as to appropriateness of the unit sought or its own authority to recognize and bargain with Petitioner, and stated no desire for a Board election or a check of the cards by a third party.<sup>4</sup> A refusal to recognize a union under these circumstances has been repeatedly held to constitute a violation of Section 8(a)(5) of the

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<sup>4</sup>As a matter of fact, Petitioner suggested to the employer that a third-party check the cards, but, upon determining that the employer had no objections to the cards as presented, subsequently suggested that a third-party check would be unnecessary. (R. Vol. 1-A, pp. 27, 28.)

Act. *Dixon Ford Shoe Co.*, 150 NLRB No. 86; *Cullen-Thompson Motor Co.*, 94 NLRB 1252, *enf'd* 201 F. 2d 369 (10th Cir., 1953); *Robert P. Scott, Inc.*, 134 NLRB 1120; *Webb Fuel Company*, 135 NLRB 309, *enf'd* 308 F. 2d 936 (6th Cir., 1962); *Greyhound Terminal*, 137 NLRB 87, *enf'd* 314 F. 2d 43 (5th Cir., 1963); *Air Filter Sales & Service of Denver, Inc.*, 142 NLRB 384; *Snow & Sons*, *supra*; *Kellogg's Inc.*, *supra*; *George Groh & Sons*, 141 NLRB 931, *enf'd* 329 F. 2d 265 (10th Cir., 1964); *Henry Spen & Company, Inc.*, 150 NLRB 21; *Jem Mfg. Co., Inc.*, 156 NLRB 62; *Harry's TV Sales*, 143 NLRB 51.

In spite of these Board and Court decisions holding that employer activity precisely identical to that of the employer herein is an unfair labor practice under Section 8(a)(5) of the Act, the Board in this case nevertheless determined that the General Counsel "has not introduced any evidence which would support a finding" that the employer sought, by its action, "to gain time within which to undermine the Union and dissipate its majority status or had completely rejected the collective bargaining principle" (R. Vol. 1, p. 24). The fact is that the record is replete with evidence supporting a finding that the employer had no genuine doubt of the Petitioner's majority status at the time of its refusal, commencing on September 25, 1964 and continuing thereafter, to recognize and bargain with the Petitioner.

Some evidence of the Board's obvious misreading of the record in this case, its own prior decisions and the decisions of this Court, is contained in a footnote



to its decision in *Jem Mfg. Co., Inc.*, supra. Pointing out there what it claimed to have found in its examination of the record in the instant case, the Board noted that the "union merely spread the authorization cards in front of the employer. The General Counsel presented *no evidence that the employer examined the cards* or made any statement that it believed the union represented a majority of its employees . . ." Footnote 6, *Jem Mfg. Co., Inc.*, supra (emphasis supplied). It is obvious from this quotation that the Board misread the record herein. There is evidence in the record of this case that the employer not only looked at the cards, but examined them *carefully* (R. Vol. 1-A, p. 18, Vol. 1-B, p. 158). As far as any affirmative statement by the employer that it believed that the Petitioner represented a majority of its employees is concerned, we respectfully submit that it is inconceivable that the absence of such an affirmative statement by an employer, under the factual circumstances of this case, operates to defeat the rights of employees to organize and bargain collectively through representatives of their own choosing within the meaning of the Act. The evidence herein clearly points to a finding that the employer regarded the Petitioner as indeed representing a majority of its auto salesmen; so much so, it is respectfully submitted, that the Petitioner had every reason to believe that a card check by a third party would be wholly unnecessary, since, as the employer witness stated at the hearing on this matter, upon examining the cards the employer's position was "What comment could I make?" (R. Vol. 1-A, p. 23).



Based upon his observation of the witnesses and their credibility, the Trial Examiner, in effect, found upon the evidence and upon his credibility determination that the employer had no good faith doubt that the Petitioner represented a majority of its auto salesmen, within the meaning of *Snow & Sons*, supra. The determination of credibility is, of course, one of the primary functions of the Board's Trial Examiner, and his findings are entitled to acceptance by the Courts. See *Skyline Homes*, 134 NLRB 155, *enf'd as modified*, 323 F. 2d 642 (5th Cir., 1963); *Howe Scale Co.*, 134 NLRB 275, *enf'd*, 311 F. 2d 502 (7th Cir., 1963). And it has been held that the existence or non-existence of a good faith doubt, in light of all the circumstances, raises mainly a question of credibility. *NLRB v. Crean* (7th Cir., 1964), 326 F. 2d 391.

Leaving aside the question of the reference to an "evanescent" majority, the Trial Examiner in effect concluded that the present case was controlled by the precedent of *Snow & Sons*, supra:

In *Snow & Sons*, 134 NLRB 709, 710-711, the Board said, "the right of an employer to insist upon a Board-directed election is not absolute. Where, as here, the Employer entertains no reasonable doubt either with respect to the appropriateness of the proposed unit or the Union's representative status, and seeks a Board-directed election without a valid ground therefor, he has failed to fulfill the bargaining requirements under the Act." Were it not for the communications received by Peri from Brave and Hoskins on or before September 30, I think that the case just referred to would dictate the decision here (R. Vol. 1, p. 16).

The Board sought to distinguish this Court's decision in *Snow & Sons*, supra, upon the ground that in that case the employer agreed to the check of cards against the payroll by a neutral third party and thereafter rejected the results of such a check and sought a Board election. In the instant case, the employer himself examined the authorization cards and was satisfied as to their identity and validity. A third party check was, therefore, completely unnecessary. If a determination to accept a third party cross check and later repudiation thereof will evidence a lack of good faith, *a fortiori*, actual direct participation in and consequent actual knowledge of majority status followed by a refusal to recognize must also constitute ample affirmative evidence of a lack of good faith doubt as to majority status.

It is respectfully submitted that an employer should not be allowed to escape its responsibilities under the Act, thus defeating its employees' rights thereunder, simply by directly participating in a card check and later repudiating the results. The cases are clear that the only necessary fact to be established is that the employer had no genuine doubt of the Petitioner's majority status and such fact, we submit, should not depend upon such a mechanistic notion as that submitted by the Board herein as to what is necessary proof of such fact.

The Board has itself recognized that the situation wherein an employer requests and then rejects a third party card check is not the only card check situation which will evidence an employer's lack of good faith doubt as to majority status. Thus, the Board has held

an employer not to have had the requisite good faith doubt which would vitiate a charge of refusal to bargain where the employer has not contested or challenged the validity of cards submitted directly to the employer by the Union. In *Jem Mfg. Co., Inc.*, supra, a case arising subsequent to the instant case, the Board declared:

Ordinarily, the General Counsel sustains this burden of proof by demonstrating that an employer has engaged in other unfair labor practices which are designed to dissipate a union's majority status. *However, an employer's bad faith may also be demonstrated by a course of conduct which does not constitute an independent unfair labor practice.* Thus, in *Snow & Sons* the employer's objective of seeking delay and its rejection of the collective bargaining concept was manifested when it repudiated a previously agreed upon card check indicating the union's majority status by continuing to insist on an election. Similarly, in *Kellogg Mills*, the Board found that the employer had manifested bad faith when, after a card check by a third party which established the union's majority and the actual commencement of bargaining negotiations, the employer withdrew from negotiations and demanded an election upon the advice of newly hired counsel. The only relevant difference between *Kellogg Mills* and this case is that in the former a third person made the card check which satisfied the employer that the union represented a majority, whereas in this case the employer himself examined the cards to determine the Union's majority. *This difference in the means of checking a union's majority is of no significance: an em-*

*ployer's check certainly is as reliable as that by a third party.* (Footnotes deleted; emphasis supplied.)

In the instant case, the evidence clearly supports a conclusion that the employer believed that the Petitioner represented a majority of its salesmen. The employer's desire to consult with its attorney, and its failure to communicate with the Union after such consultation, with respect to the Petitioner's request for recognition, amply manifests a complete rejection of the principle of collective bargaining. See *NLRB v. Dahlstrom Metallic Door Co.*, 112 F. 2d 756 (2nd Cir., 1940); *George Groh & Sons*, 141 NLRB 931, *enf'd* 329 F. 2d 265 (10th Cir., 1964). The Trial Examiner herein concluded that such tactics were engaged in by the employer with the hope that the Union "would just go away" (R. Vol. 1, p. 16). Perhaps no clearer case of employer rejection of the collective bargaining principle can be found. The Board has held, with judicial approval, that a failure to answer, or undue delay in answering, a request for bargaining is not consistent with a good faith doubt. *NLRB v. Howe Scales*, 134 NLRB 275, *enf'd* 311 F. 2d 502 (7th Cir., 1963); *Economy Food Center, Inc.*, 142 NLRB 901, *enf'd* 333 F. 2d 468 (7th Cir., 1964).

Evidence of the employer's antipathy to the Petitioner and its demand for recognition, which tends to support a finding of lack of good faith doubt of the Petitioner's majority status, is also found in a series of events occurring after the demand for recognition and attendant refusal by the employer.

Union pickets Bostick and Walker testified without contradiction of a number of threats by various employer representatives. A number of these threats occurred in the presence of some of the unit auto salesmen employees (R. Vol. 1-A, pp. 118-120). Union picket Pimental was threatened by management with bodily harm a dozen or more times during October and November 1964 (R. Vol. 1-A, pp. 123, 124, 125, 126, 127). Clearly, evidence of this nature supports a finding of lack of good faith doubt by the employer of the Petitioner's majority status and provides guidance in a determination of the employer's motivation for its refusal to recognize and bargain with the Union. See *Bernel Foam Products Co.*, 146 NLRB 161 (where the pertinent employer activity occurred about two weeks after the refusal to bargain), and *Johnnie's Poultry Co.*, 146 NLRB 98.

The Trial Examiner failed to make any finding of independent employer violations under 8(a)(1) of the Act for the reason that there was no allegation in the General Counsel's complaint respecting these incidents. However, the employer had full opportunity to litigate the question of threats to pickets, and did so, and, it is submitted, the Trial Examiner should have found that the employer committed independent unfair labor practices within the meaning of Section 8(a)(1) of the Act because it made its threats in the presence of the employees in the unit for which the petitioner sought representative recognition. See *Independent Metal Workers Union, Local 1, (Hughes Tool Co.)*, 147 NLRB 166; *NLRB v. Puerto Rico Rayon Mills*, 293 F. 2d 941 (1st Cir. 1961). And, of



course, it is respectfully submitted that said activity significantly supports a finding of union animus bearing on the employer's refusal to bargain with the Petitioner. See *Cosmodyne*, 150 NLRB 1.

The criterion in this case is whether there is sufficient evidence on the record considered as a whole, taking into account whatever detracts from its weight, to support the Board's dismissal of the Complaint herein upon the ground that no evidence was introduced to show absence of good faith doubt by the employer with respect to Petitioner's status as the representative of the majority of the employer's auto salesmen. It is respectfully submitted that the Board has apparently misread the record since there is contained therein ample evidence of the absence of a *bona fide* doubt by the employer of the Petitioner's majority status at the time the employer refused and declined to recognize and bargain with the petitioner.

This case falls directly within the rule of the Board and this Court in *Snow & Sons*, *supra*, and the Board's attempt to distinguish that case from the instant matter, as evidenced by the rationale contained in its footnote to the decision in *Jem Mfg. Co., Inc.*, 156 NLRB 62, must be regarded as illogical and unreasonable, and in direct contravention of the Congressional policy manifested in the Act to provide employees with an untrammelled right to organize and bargain collectively with their employers. It is respectfully submitted that the plain language of the Act, the decisions of the Board and the Courts under the Act clearly provide that an employer *must* bar-



gain collectively with the representative of his employees' choosing, upon a request to do so, unless that employer entertains a genuine doubt of the majority status of his employees' representative. In the instant case, the Board's Trial Examiner determined that the employer had no good faith doubt of the Petitioner's majority status and the evidence contained in the record overwhelmingly supports such a finding. Therefore, it is respectfully submitted that the Board erroneously dismissed the Complaint when it expressly determined that there was no evidence to support the Trial Examiner's finding of lack of good faith doubt on the part of the employer.

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### CONCLUSION

For the foregoing reasons the order of the Board should be set aside and the Board should be ordered by the Court to find that the employer violated Section 8(a)(5) of the Act when it refused to bargain with Petitioner upon request and to thereupon issue an order requiring the employer to recognize and bargain with the Petitioner. *Franks Bros. Co. v. NLRB*, 321 U. S. 702.

Dated, San Francisco, California,  
June 14, 1964.

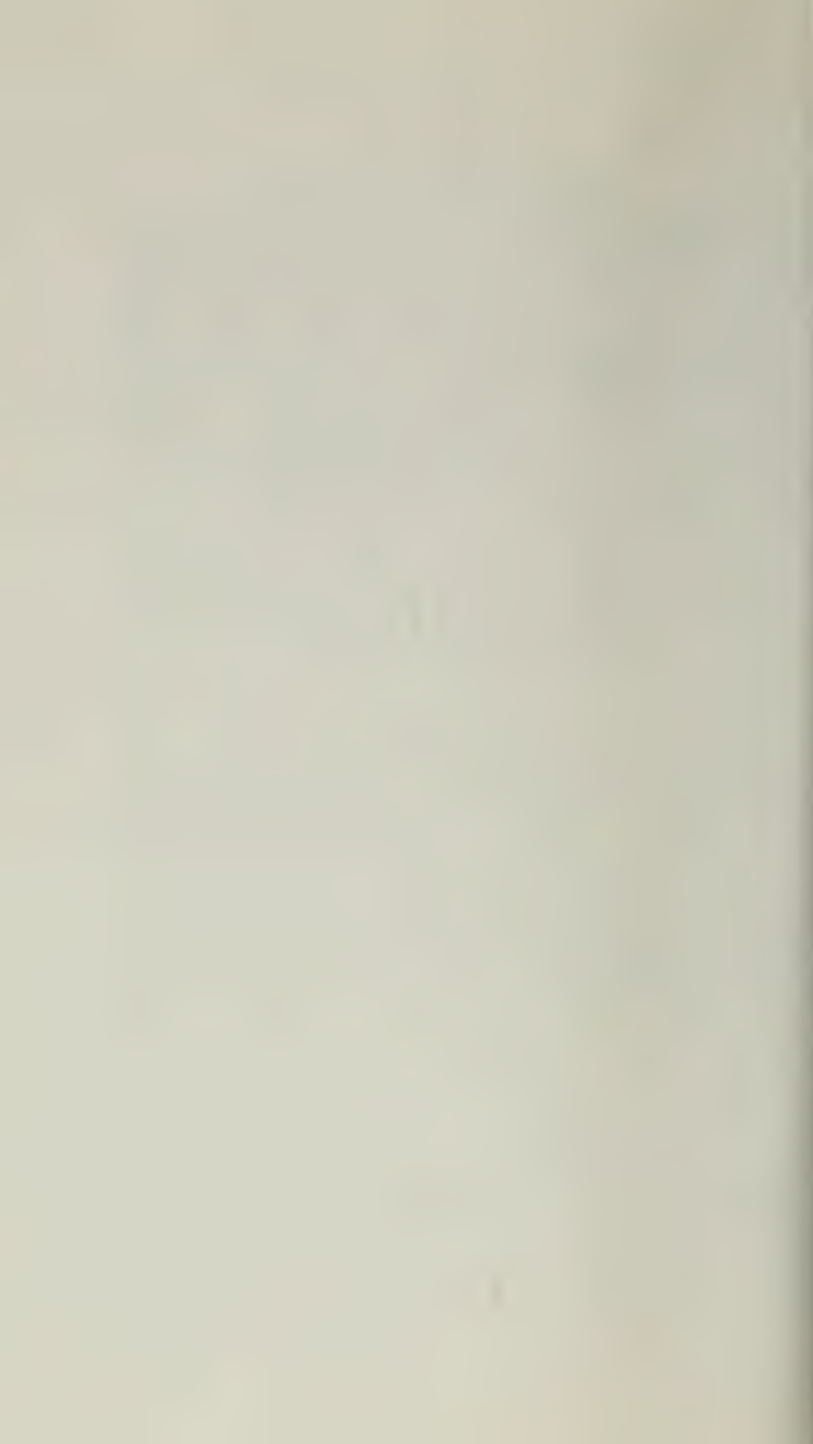
Respectfully submitted,  
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## CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROLAND C. DAVIS,

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**In the United States Court of Appeals  
for the Ninth Circuit**

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RETAIL CLERKS UNION, LOCAL NO. 1179, RETAIL  
CLERKS INTERNATIONAL ASSOCIATION, AFL-CIO,  
PETITIONER

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

---

**On Petition to Review An Order of the  
National Labor Relations Board**

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**BRIEF FOR THE NATIONAL LABOR RELATIONS  
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---

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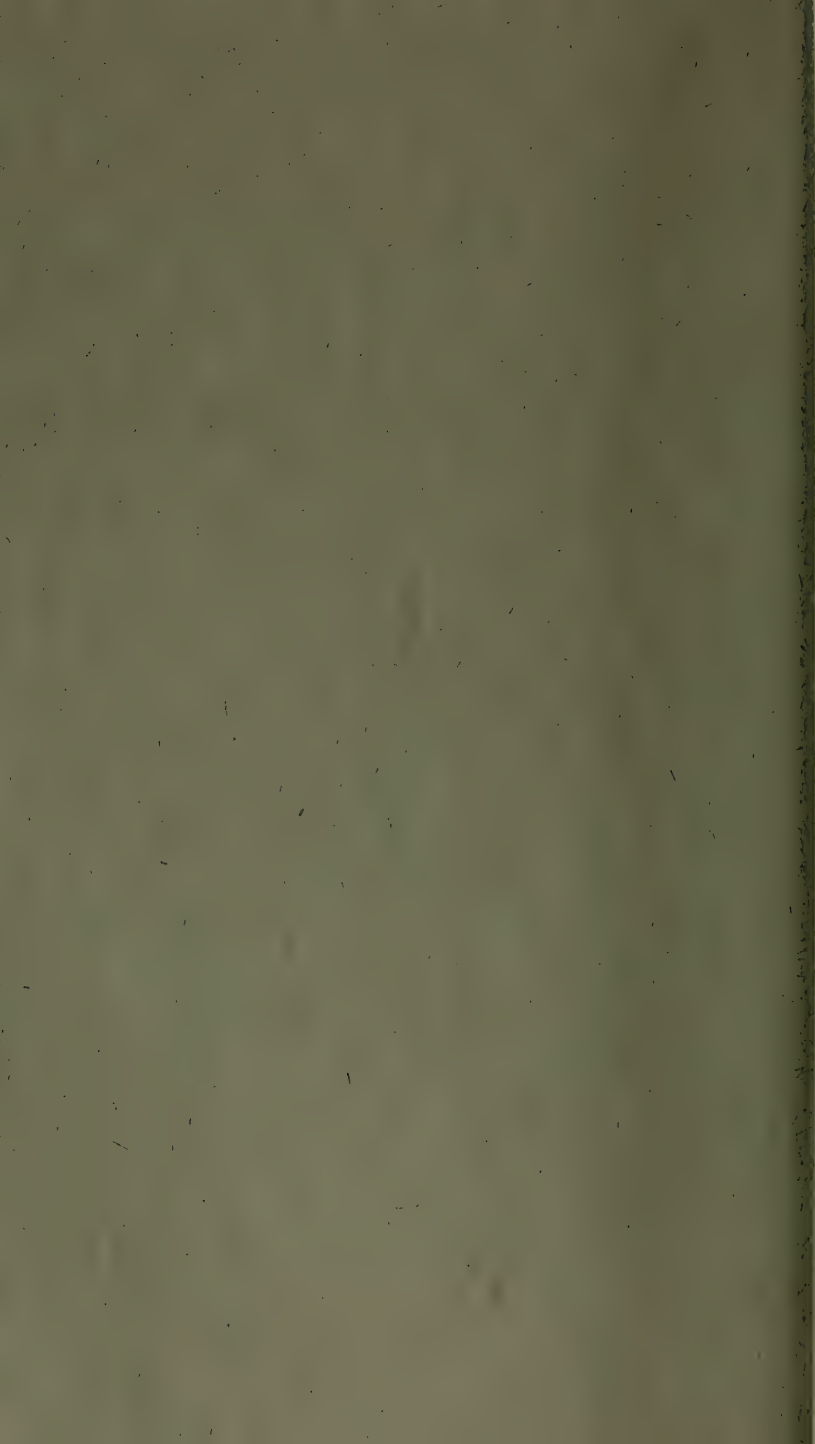
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**FILED**

**SEP 19 1966**

**WM. B. LUCK, CLERK**

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 20,781

RETAIL CLERKS UNION, LOCAL NO. 1179, RETAIL  
CLERKS INTERNATIONAL ASSOCIATION, AFL-CIO,  
PETITIONER

*v.*

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

---

**On Petition to Review An Order of the  
National Labor Relations Board**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS  
BOARD**

---

**JURISDICTION**

This case is before the Court upon petition of Retail Clerks Union, Local No. 1179, Retail Clerks International Association, AFL-CIO (the Union), to review and set aside an order of the National Labor Relations Board dismissing the complaint against John P. Serpa, Inc. (the employer), on October 8, 1965, following the usual proceedings under Section 10(c) of the National Labor Relations Act, as amended (61

Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*). The Board's decision and order (R. 23-25)<sup>1</sup> are reported at 155 NLRB No. 12. This Court's jurisdiction is invoked under Section 10(f) of the Act.

### COUNTERSTATEMENT OF THE CASE

The employer is a corporation engaged in the retail sale of automobiles at Martinez and Concord, California (R. 5, 9, 13). John P. Serpa, an owner of the Company for 43 years, currently owns 50 percent of the shares of the corporation; he is ill and no longer able to work (Tr. 49-50). Fred Peri owns the remaining shares and is the general manager (Tr. 12).

The employer is a member of the Contra Costa Automotive Association, Inc., which is authorized to represent the Company "in all matters pertaining to our employee relations . . ." and to act in its behalf "in the negotiation, execution and administration of collective bargaining agreements with labor unions . . . on the subject of wages, hours, working conditions, and other terms of employment. . ." (R. Exh. 5).<sup>2</sup> Pursuant to this authorization, the association

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<sup>1</sup> References designated "R". are to Volume I of the Record as reproduced pursuant to Rule 10 of this Court. References designated "Tr." are to the reporter's transcript of testimony as reproduced in Volume II of the Record. References designated as "G.C. Exh.", or "R. Exh.", are to exhibits of General Counsel and Respondent, respectively.

<sup>2</sup> Thus, petitioner's comment (Br. p. 3) that Peri is "in charge" of the employer's labor relations is misleading. The employer has had no labor relations other than through the association and Peri is completely inexperienced in dealing with labor organizations (Tr. 13, 105).

has negotiated collective bargaining agreements with the unions<sup>3</sup> which represent various of the employer's employees (R. 14; R. Exh. 1, Tr. 9-10). The employer's salesmen, the subject of this proceeding, have never been represented by a union (Tr. 49).

At the time of the events in question, the Company employed 7 salesmen, 5 at Martinez and 2 at Concord. In September 1964, the Union undertook to organize them,<sup>4</sup> and on September 25 had obtained 5 authorization or application cards (G.C. Exh. 3a-3e). At approximately 5:50 p.m. on Friday, September 25, Union agents, Roddick, Paddock and Atkinson presented themselves to Peri at the employer's Martinez office. Roddick handed Peri a letter demanding recognition (G.C. Exh. 2; Tr. 16), and a recognition agreement (G.C. Exh. 4); he also spread the five cards on the table, suggesting that Peri check them against a payroll.<sup>5</sup> After reading the letter and glancing briefly at

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<sup>3</sup> Lodge 1173, International Association of Machinists, and General Truck Drivers and Helpers, Local No. 315.

<sup>4</sup> On September 16, 1964, the Union began picketing the employer's Martinez premises with "informational" signs. During the first week in October the signs were changed to protest "unfair practices," and the picketing continued until about December 19, 1964 (R. 15; Tr. 14-15, 122, 146). None of the employees engaged in the picketing. When the picketing first began, Union organizer Paddock told Peri that the Union was going to organize the salesmen. Peri told him (Tr. 143) "we have a union in the back, and we deal as an Association. Why don't you go over there and get everybody organized, and we have no problems?"

<sup>5</sup> Roddick later withdrew this suggestion since he considered a card check unnecessary (Tr. 27-28). Contrary to the assertion in the Union's brief (Br. pp. 3, 11, 15) none of the Un-



the recognition agreement, Peri asked Roddick, "What does this mean? \* \* \* I don't understand what this is all about" (R. 14; Tr. 17, 20, 22, 70-71, 85).<sup>6</sup> Roddick told him that the Union wanted recognition; he also told Peri that he "was entitled to a lawyer to have this clarified better" (R. 14, 23; Tr. 20, 22), and suggested that Peri call his attorney. Peri replied that he could not get an attorney so late in the day but could "probably get him tomorrow" (Tr. 20). The Union representatives agreed and did not press for immediate recognition. As they prepared to leave,<sup>7</sup> Roddick gave Peri a business card on which he wrote his home telephone number. Roddick then warned Peri about firing or "being a little bit rough" with employees who had signed cards (Tr. 86). Peri replied, "Hell, no, they have the right to sign if they want to." According to Roddick, "these were his exact words, that it reflected his feeling" (Tr. 86). A few days

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ion's agents offered to have the cards checked by a neutral third party, and, as shown, the Union dropped its suggestion that the employer himself, at the September 25 meeting, check the cards against the payroll.

<sup>6</sup> At some point during this meeting Peri said to Paddock, "I can't sign it. \* \* \* You know I can't sign it" (Tr. 23, 165). This apparently referred to the fact that Peri had previously (see n. 4, *supra*) told Paddock that the employer conducted its labor relations through the association, and to Peri's belief that he was bound by the terms of his authorization to the association which contained a promise not to enter into any agreement with any bargaining representative "unless and until such agreement . . . has first been submitted to and approved in writing by the Association" (R. Exh. 5, par. 3).

<sup>7</sup> The entire meeting lasted approximately 5 minutes (Tr. 46).

later Peri expressed "his feeling" directly to some of the employees when they sought to discuss the Union with him.<sup>8</sup> "I told them this was their business; they could do what they wanted" (Tr. 145).

Peri consulted his attorney on Saturday, September 26, but did not thereafter call Roddick (R. 14, 24; Tr. 24, 144, 149-150). The Union did not, after the September 25 meeting, call the employer, did not attempt to determine whether Peri had signed the recognition agreement, and gave no consideration to further contact with the employer (R. 16; Tr. 75, 82, 97, 98, 99). Instead, not having heard from Peri by Tuesday, September 29, the Union's attorney prepared an unfair labor practice charge (R. 3), which was filed the following day.

A day later, on October 1, Peri met Union agent Atkinson at the Concord lot. Atkinson asked if the employer had signed the agreement. Peri replied that he had not, and that if the Union wanted recognition it should contact Mr. Shepherd of the dealers' association (R. 14; Tr. 31, 32, 61, 74, 78). Atkinson replied that he had seen Shepherd that morning.

On October 13, 1966, the employer filed a representation petition with the Board seeking an election among the employer's salesmen (R. 15; Tr. 8, 136). Because of the pendency of the Union's unfair labor practice charge, no election has been held.

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<sup>8</sup> By September 30, Peri had received written notification from two employees informing him that they no longer wanted the Union to represent them (R. 14; R. Exh. 2, 3). The Union received similar notification from four employees at a later date (Tr. 99-101).

## THE BOARD'S CONCLUSION AND ORDER

The Board, adopting the fact findings, credibility resolutions and conclusion of the Trial Examiner, dismissed the complaint.<sup>9</sup> Upon the foregoing facts it concluded that the General Counsel had not sustained his burden of proving that the employer's failure to recognize the Union was motivated by bad faith, i.e., the evidence failed to show that the employer declined to recognize the Union in order to gain time in which to undermine its majority status, or that his failure to grant recognition manifested a rejection of the collective bargaining principle.

## ARGUMENT

### The Board Properly Dismissed the Complaint

#### A. *The controlling principles*

##### 1. *The statutory standard*

As noted, *supra*, pp. 3-4, in a brief meeting with Peri, the Union's agents demanded recognition, presented authorization cards from 5 of the employer's 7

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<sup>9</sup> The Trial Examiner found that the designation cards did not reliably evidence the considered preference of the signers (R. 16), in view of the almost immediate withdrawal by the employees of their authorizations to the union. (R. 14, 16; R. Exh. 2, 3; Tr. 99-101) Accordingly, he concluded that it would not effectuate the policies of the Act "to proclaim the union to be the exclusive representative of [Serpa's] salesmen upon the basis of such a fleeting and evanescent majority" (R. 16). Since the Board decided the case on other grounds, it did not pass upon the Trial Examiner's rationale insofar as it rested upon his finding of a "fleeting and evanescent" majority (R. 24, n. 2).

salesmen, advised Peri that he was "entitled to a lawyer to have this clarified better," and received his assurances that he would not punish the employees for having signed cards. On these undisputed facts,<sup>10</sup> the Board dismissed the complaint, concluding that they were insufficient to establish a *prima facie* case that the employer's failure to recognize the Union was motivated by bad faith. Thus, the issue in the instant case is whether the Board could reasonably have found that the preponderance of the evidence failed to sustain the allegations of the complaint. Where, as here, the Board finds that an employer's conduct did not violate the Act, its determination will be upheld unless it has "no rational basis," *Mississippi Valley Barge Line Co. v. U.S.* 292 U.S. 282, 286-287; *International Woodworkers v. N.L.R.B.*, 263 F. 2d 483, 485 (C.A. D.C.); *Amalgamated Clothing Workers v. N.L.R.B.*, — F. 2d — (C.A. D.C.) 62 LRRM 2431, 2440, or unless

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<sup>10</sup> Petitioner erroneously characterizes this case as one in which the Board's factual determinations conflict with those of the Trial Examiner, contending that such conflict weakens the Board's ultimate conclusion. There is no conflict between the Examiner and Board with respect to "evidence supporting [the Board's] conclusion." *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474, 496. Rather, the difference between them on the good faith issue (as petitioner implicitly concedes (Br. p. 15, second paragraph)), is whether the undisputed facts amount to a violation of law. The ultimate disposition of such questions is clearly for the Board—not the Trial Examiner. *Oil Chemical and Atomic Workers, etc. v. N.L.R.B.*, — F. 2d — (C.A. D.C.), 62 LRRM 2238, 2240. Moreover, as is apparent, *infra*, p. 8, the Trial Examiner, to the extent his decision conflicts with the Board's on the good faith issue, applied an incorrect standard in shifting the burden of proof from the General Counsel to the employer.

“the evidence required the Board to uphold the claim.” *Amalgamated Clothing Workers v. N.L.R.B.*, 334 F. 2d 581 (C.A. D.C.). The Union can make no such showing here. Accordingly, the Board’s dismissal of the complaint should be sustained.

## 2. *Burden and elements of proof*

The premise implicit in petitioner’s contentions is that an employer who has declined to recognize a union on the basis of a majority card showing, must, in order to avoid the proscription of Section 8(a)(5), carry the burden of proving that it was not guilty of bad faith when it declined recognition. In the Board’s view, however, the initial burden is on the General Counsel, and the employer need not come forward to justify a refusal to accord recognition until the General Counsel has established a *prima facie* case of bad faith. Thus:

In a case such as this, where an employer refuses to recognize a union upon a showing that a majority of its employees in an appropriate unit have signed cards designating the union as their representative, our recent decisions have made it clear that the critical issue is whether the General Counsel has carried the burden of showing that the refusal to bargain was in bad faith. [Footnote omitted.]

*Drug King, Inc.*, 157 NLRB No. 30.<sup>11</sup> Furthermore,

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<sup>11</sup> Accord: *Jem Manufacturing Inc.*, 156 NLRB No. 62; *Strydel Incorporated*, 156 NLRB No. 114; *Ben Duthler, Inc.*, 157 NLRB No. 3; *Aaron Brothers Company of California*,



Absent an affirmative showing of bad faith, an employer, presented with a majority card showing and a bargaining request, will not be held to have violated his bargaining obligation under the law simply because he refuses to rely upon cards, rather than an election, as the method for determining the union's majority. [Footnote omitted.]

*Aaron Brothers Company of California, supra*, n. 11.<sup>12</sup>

Such an "affirmative showing of bad faith" may be demonstrated by evidence that the employer, believing the union to be the representative of his employees, refused recognition in order to gain time within which to undermine the union and dissipate its majority status,<sup>13</sup> or because he rejected the statutory principle of collective bargaining.<sup>14</sup> Such a determination requires, in turn, an assessment ". . . of all relevant facts in the case, including any unlawful conduct of the employer, the sequence of events, and the time lapse between the refusal and the unlawful conduct." *Joy Silk Mills, Inc. v. N.L.R.B., supra* at 741.

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158 NLRB No. 108; *Mutual Industries, Inc.*, 159 NLRB No. 73; *Master Transmission Rebuilding Corporation & Master Parts, Inc.*, 155 NLRB No. 35; *Hammond & Irving, Incorporated*, 154 NLRB No. 84; *Oklahoma Sheraton Corp.*, 156 NLRB No. 69.

<sup>12</sup> Accord: *Briggs IGA Foodliner*, 146 NLRB 443; *Cameo Lingerie, Inc.*, 148 NLRB 535; *Strydel, Incorporated, supra*, n. 11.

<sup>13</sup> See, e.g., *Joy Silk Mills, Inc. v. N.L.R.B.*, 185 F. 2d 732, 741 (C.A.D.C.), cert. denied, 341 U.S. 914; *N.L.R.B. v. Trimfit of California, Inc.*, 211 F. 2d 206 (C.A. 9).

<sup>14</sup> See, e.g., *N.L.R.B. v. George Groh & Sons*, 329 F. 2d 265 (C.A. 10).



Although the commission of unfair labor practices contemporaneous with a refusal to recognize is a powerful indication of employer bad faith, not all unfair labor practices are of a kind or gravity to denote a purpose to deprive employees of their right to collective bargaining.<sup>15</sup> On the other hand, bad faith may be indicated by conduct which does not amount to an unfair labor practice. For instance, in *Snow v. N.L.R.B.*, 308 F. 2d 687 (C.A. 9), the union achieved a card majority and asked for recognition. The employer, through counsel, assured the union that it did not believe the union had used illegal or coercive tactics in obtaining the employees' signatures, and agreed to abide by a card check in determining whether to recognize the union. A minister, after verifying the employees' signatures, made a written report to the employer confirming the union's majority status. The employer then reneged on his agreement and refused to recognize the union. This Court affirmed the Board's finding that such conduct clearly indicated bad faith. See also, *N.L.R.B. v. Hyde*, 339 F. 2d 568 (C.A. 9); *N.L.R.B. v. Kellogg Mills*, 347 F. 2d 219 (C.A. 9), enforcing 147 NLRB 342; *N.L.R.B. v. George Groh & Sons*, 329 F. 2d 265 (C.A. 10); *Jem Mfg. Inc.*, 156 NLRB No. 62.

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<sup>15</sup> See, e.g., *Cameo Lingerie, Inc.*, 148 NLRB 535, 538; *Cosmodyne Manufacturing Company*, 150 NLRB 96, 104, n. 29; *Hammond & Irving, Inc.*, 154 NLRB No. 84; *Clermont's, Inc.*, 154 NLRB No. 111; *Strydel, Inc.*, 156 NLRB No. 114; *Aaron Brothers of California*, 158 NLRB No. 108. See also, *N.L.R.B. v. Flomatic Corporation*, 347 F. 2d 74 (C.A. 2).

**B. *The General Counsel did not carry the burden of proving that the employer's failure to recognize the Union was motivated by bad faith***

Applying the foregoing principles, we submit that the Board could properly find that the evidence adduced in this case was insufficient to establish that the employer's failure to recognize the Union was motivated by bad faith. Although he knew on September 16 that the Union was attempting to organize his employees, he did not commit unfair labor practices,<sup>16</sup> or make anti-union speeches, or engage in a campaign of interrogation, or threaten his employees either before or after the Union told him that some had signed cards. In fact, the contrary is true; Peri assured the Union representative *and* the employees that he considered the matter of unionization to be the employees' business—not his (see pp. 4-5, *supra*). Plainly, then, Peri did not, on September 25, decline recognition in order to engage in conduct designed to dissipate the Union's strength. Nor did Peri show hostility to the collective bargaining principle; most of his employees were unionized, and he bargained with two unions through the employer association. He repeatedly told the Union representatives here that he would prefer to deal with them through the association.<sup>17</sup>

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<sup>16</sup> See, pp. 20-24, *infra*.

<sup>17</sup> Petitioner's attempt (Pet. Br. pp. 5, 10) to attribute an anti-union state of mind to Peri is based on a statement in Union agent Atkinson's October 1 report to the Union that Peri said he would never deal with the Union. Petitioner's contentions with respect to this incident are grossly misleading because it has taken the statement wholly out of context. A reading of the entire testimony (Tr. 31, 32, 61, 74, 78)

Thus, petitioner's case boils down to the contention that a union's tender of cards to an employer, if made in a manner that permits the employer to examine the cards, is sufficient to erase all doubt in the employer's mind regarding the union's status. Proceeding from this assumption, petitioner argues that the employer had "actual knowledge" (Br. p. 15) of the Union's majority status, and that the failure to recognize the Union in such circumstances, without more, evidences the employer's bad faith. Petitioner also argues (Br. p. 17) that the employer's desire to consult with its attorney and its failure to communicate with the Union thereafter,<sup>18</sup> "amply manifests a complete rejection of the principle of collective bargaining." These contentions are wholly without merit.

We submit that the Board was clearly correct in concluding that a mere examination of proffered authorization cards "cannot create the obligation to bargain or establish [the employer's] bad faith" (R. 24). An examination can indicate that a majority of employees have signed cards; it cannot, alone, indicate the circumstances under which the signatures were solicited or obtained, or resolve the question whether the cards reliably express the employees' desire for

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shows clearly that Peri was merely restating his consistently held position (Tr. 23, 31, 32, 61, 74, 78, 105, 108, 143, 165), that he would prefer to deal with the Union through the association rather than in a single-employer unit. This was Atkinson's understanding of Peri's statement at the time he reported it to the Union (Tr. 74).

<sup>18</sup> Peri consulted with his attorney on September 26. The Union prepared an unfair labor practice charge on September 29, and filed it the following day.

representation.<sup>19</sup> Accordingly, absent an affirmative showing of bad faith, based on evidence extrinsic to the cards themselves, an employer does not violate Section 8(a)(5) if he declines recognition when faced with a request to bargain and a proffer of cards, and instead petitions for a Board-conducted election. For it is universally acknowledged that where, as here, an employer has not engaged in conduct that would distort the election process, "an election by secret ballot is normally a more satisfactory means of determining employees' wishes . . . ." *Aaron Brothers Company of California*, 158 NLRB No. 108.<sup>20</sup>

Petitioner's attempt to liken this case to *Snow*, *supra*, is unavailing. There is no evidence in this case that the employer had independent, reliable knowledge that the Union represented a majority of his employees when he declined recognition. In *Snow*, the employer expressed satisfaction that the cards were properly obtained, and agreed to consider them an accurate reflection of his employees' desires; when the card check which he had agreed would settle the

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<sup>19</sup> The Trial Examiner found, in view of the almost immediate withdrawal by two of the employees of their authorizations to the Union, that the cards "did not reliably evidence the considered preference of the signers" (R. 16). See n. 9, *supra*.

<sup>20</sup> See also, *The Cudahy Packing Co.*, 13 NLRB 526, 531-532; *N.L.R.B. v. Flomatic Corporation*, 347 F. 2d 74, 78 (C.A. 2), and authorities there cited. Address of Board Chairman McCulloch, 1962 Proceedings, Section of Labor Relations Law, American Bar Association, 14-17; Bok, *The Regulation of Campaign Tactics in Representation Elections Under The National Labor Relations Act*, 78 Harv. L. Rev. 38, 122.

matter showed that the union did represent a majority of his employees, he reneged and refused recognition. It is apparent that in *Snow*, the employer accepted the cards but rejected the union and the collective bargaining principle. In contrast, in the case at bar, the employer had no opinion with respect to the reliability of the cards or the true desires of his employees,<sup>21</sup> and declined recognition in order to seek legal advice—a course of conduct in which the Union fully acquiesced at the time but which it now brands as a rejection of the collective bargaining principle.<sup>22</sup> Since Peri did not accept the cards as a reliable indication of his employees' wishes, a card check by a

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<sup>21</sup> Contrary to petitioner's contentions (Br. pp. 11, 15), Peri did not have "actual knowledge" that the Union represented a majority of his employees, and did not concede at the September 25 meeting that he did. Peri's actual knowledge was limited to the facts that he employed seven salesmen and that the Union presented five authorization cards. His remark "what comment could I make?", on which petitioner so heavily relies (Br. pp. 4, 13), reflects not to Peri's belief that the Union represented the employees, but to the indisputable fact that the Union presented five cards—a fact which is conceded (Tr. 158) but which is insufficient in itself to establish the employer's obligation to bargain. See, e.g., *Snow v. N.L.R.B.*, 308 F. 2d 687, 691 (C.A. 9); *Amalgamated Clothing Workers v. N.L.R.B.*, — F. 2d — (C.A.D.C.), 62 LRRM 2431.

<sup>22</sup> The Examiner's decision takes note of the Union's agreement that the employer should consult his attorney: ". . . it is not asserted that Peri acted improperly in delaying action so that he might obtain counsel and I think it doctrinaire to conclude that by failing to communicate with the Union before September 30 he demonstrated a determination not to afford the salesmen their right to have representation" (R. 16). See, *infra*, pp. 15-16.



neutral party or directly by the employer would have been pointless.<sup>23</sup>

Petitioner's further contention (Br. p. 17), that the employer's desire to consult his attorney, and his subsequent failure to communicate with the Union (between September 26 and 30) "amply manifests a complete rejection of the principle of collective bargaining" is a gross exaggeration. Assuming, *arguendo*, that an employer's desire to consult his attorney when faced with a demand to make a legal commitment could ever be considered an unfair labor practice or evidence of bad faith, this case is surely not an appropriate vehicle for such a finding. Here, Peri, completely inexperienced in matters of this sort,<sup>24</sup> was confronted by three Union officials who demanded that he sign a recognition agreement. Faced with that demand, Peri expressed his lack of understanding with respect to the import or significance of the obligations he was being asked to assume. Union agent Roddick acknowledged Peri's dilemma and suggested that he "was entitled to a lawyer to

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<sup>23</sup> Petitioner's attempt to imply (Br. p. 15) that the employer directly participated in a card check and then repudiated the "results," is unsupported by the record. As noted, *supra*, n. 5, the Union dropped its suggestion that Peri check the cards against the payroll, and left the September 25 meeting without having the signatures verified. Thus, there was no check and no "results" to be repudiated by the employer. In any event, even had the Union insisted on a check of the cards, the employer could have refused, without violating Section 8(a)(5) of the Act. *Strydel Incorporated*, 156 NLRB No. 114.

<sup>24</sup> The Company's labor relations are handled by an employer association, *supra*, pp. 2-3, n. 2.



have this clarified better" (Tr. 20, 22). The Union agents left shortly thereafter, deferring their demand for recognition until after Peri consulted his attorney. At the hearing Union agent Roddick conceded that the Union made no further attempt to contact the employer, indeed, did not even consider such a course of action. Instead, not knowing whether the employer had signed the agreement or had consulted his attorney, the Union, five days after its only meeting with the employer, filed a charge alleging a bad faith refusal to bargain. Under these circumstances, we submit that petitioner's contention that the employer rejected the collective bargaining principle finds no support in the record. Cf. *Phelps Dodge Corp. v. N.L.R.B.*, 354 F. 2d 591 (C.A. 7).<sup>25</sup>

In sum, petitioner has failed to show that the evidence adduced at the hearing—involving mostly inaction by both Union and employer—requires a finding that the employer was motivated by bad faith in failing to recognize the Union on September 25. Indeed, the Trial Examiner found it necessary to distinguish between 1) the fact that recognition was not granted, and 2) a conscious decision by the employer not to recognize the Union; he held that there was no support in the record for the latter (Tr. 159).

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<sup>25</sup> In *N.L.R.B. v. Howe Scales, Inc.*, 311 F. 2d 502 (C.A. 7), the case cited by petitioner to support its contention that failure of the employer to contact the union within four days, constitutes "undue delay," the union had written to the employer twice, but did not receive an answer for six weeks. The other case cited by petitioner (*Economy Food Center, Inc.*, 142 NLRB 901, enf'd. 333 F. 2d 468 (C.A. 7)), does not appear to stand for the proposition for which it is cited.

Such a finding is surely not tantamount to the "affirmative showing of bad faith" (*Aaron Brothers of California, supra*) required to support an unfair labor practice finding in this type of case.

Petitioner has cited a dozen cases (Br. p. 12) which, it claims, show that the Board has held conduct "precisely identical" to this employer's to be an unfair labor practice. Its contention is refuted by every case it cites; as we now show, each is distinguishable from the instant case in a substantial and significant way. *Dixon Ford Shoe Co., Inc.*, 150 NLRB 861, is a case precisely like *Snow, supra*, in which the employer agreed to accept authorization cards as an accurate reflection of the employees' desires, and then refused recognition when the cards showed a majority for the union. In *Cullen-Thompson Motor Co.*, 94 NLRB 1252, enf'd. 201 F. 2d 369 (C.A. 10), the employer had no doubt about the union's majority status and told the union that there was no reason why he should not recognize and bargain with it; he later refused to do so, informing the union he would not even honor a certification based on a Board election. In *Robert P. Scott, Inc.*, 134 NLRB 1120, the employer accepted the authorization cards as indicative of a union majority, but then informed the union that he could "fire all these men," that he would not negotiate, that he "would never work Union," and that he would operate his business any way he wanted. In *Webb Fuel Company*, 135 NLRB 309, enf'd. 308 F. 2d 936 (C.A. 6), the employer, after being informed by the union that it

had signed up his only two office employees, asked both employees if they had joined. The employees confirmed the fact, but the employer then refused recognition. In *Kellogg Mills*, 147 NLRB 342, enf'd. 347 F. 2d 219 (C.A. 9) and *Jem Mfg., Inc.*, 156 NLRB No. 62, the employers acknowledged the unions' majority status and commenced bargaining. Thereafter, in each case, the employer retained new counsel, and withdrew recognition, claiming that prior to commencing negotiations it actually had a good faith doubt as to the unions' majority. Similarly, in *Air Filter Sales & Service of Denver, Inc.*, 142 NLRB 384, the employer first accepted the union's majority, established by authorization cards, and proceeded to discuss contract proposals. Later, the employer evaded the union and failed to return its numerous phone calls. Finally, the company's board of directors and officers refused to deal with the union on the ground that the financial condition of the company precluded unionization of its employees. In *Greyhound Terminal*, 137 NLRB 87, 89, enf'd. 314 F. 2d 43 (C.A. 5), the employer told the union that there was no doubt in his mind that the union represented his employees. Later he said he had "talked too much" and demanded an election. The employer in *George Groh & Sons*, 141 NLRB 931, enf'd 329 F. 2d 265 (C.A. 10), declined a card check saying that "he was satisfied" that the union represented the employees. Despite such acknowledgement he told the union's officials that he wasn't interested in the union, that they were wasting their time because he wanted no part of the union. When the

union persisted, the employer sent its counsel to his lawyer, who, it turned out, was not in town. The employer then advised union's counsel that it had retained another attorney to represent it and suggested he deal with that attorney. When the union's attorney sought to do so, he was advised that the attorney had not been retained by the employer. In *Henry Spen & Company, Inc.*, 150 NLRB 138, the employer consistently evaded meeting with the union. During a 10-day period the union repeatedly telephoned the employer's representative, but was told each time that he was not in. The calls were never returned. Finally, the union sent a telegram to the employer offering to make available to him "documentary proof of its status as majority representative of your employees" (*id.* at 153). The company did not reply. In *Harry's TV Sales*, 143 NLRB 450, the union received signed authorizations from all six of the employer's employees. It submitted the cards and asked for recognition. At the same time, all employees picketed the employer's premises. When the employer's attorney asked for an opportunity to investigate the circumstances under which the cards were signed, the union's agent offered to make all employees available for questioning and suggested an immediate election. Employer's counsel then declined recognition on the basis that the employer would be put in an unfair competitive position if it had to meet the union's "ridiculous" demands (*id.*, at 453). The employer then committed unfair labor practices which broke the strike.

Thus, contrary to petitioner, it is evident that the Board has not held an employer in violation of Section 8(a)(5) under the circumstances present here. For a mere proffer of cards, an agreement that the employer would consult his attorney, and an absence of communication for 4-5 days are clearly an insufficient basis on which to make "an affirmative showing of bad faith."<sup>26</sup>

*C. Petitioner's remaining contentions are without merit*

Petitioner contends that the Board erred in failing to find that the employer violated Section 8(a)(1) of the Act by threatening certain pickets (not employees) on various occasions from mid-October to mid-November. It argues, in effect, that such conduct shows that the employer, in declining recognition on September 25, did so in bad faith, intending to gain time in which to dissipate the Union's support. Both contentions are without merit.<sup>27</sup>

It is clear that the issue now injected by the Union was not properly before the Trial Examiner or Board. The complaint (R. 5-8) did not allege that the employer had violated Section 8(a)(1) of the Act and did not allege conduct which could support such a

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<sup>26</sup> See *Superex Drugs, Inc.*, 150 NLRB 972, and cases cited, *supra*, n. 12.

<sup>27</sup> The Trial Examiner, whose decision was affirmed by the Board, refused to find a Section 8(a)(1) violation because the complaint failed to allege either a violation of that section, or any conduct which could support such a finding (R. 5-8, 15). He found, in any event, that "the threats were uttered some time after the Union had lost its majority and have no relevance to that loss" (R. 16).



finding. Neither General Counsel nor petitioner sought to include such allegations by amending the complaint,<sup>28</sup> and no motion was made to conform the pleadings to the proof. Under the circumstances, it is clear that the employer did not have notice or sufficient opportunity to fully litigate an 8(a)(1) issue and in fact did not do so. Although counsel for employer cross-examined the Union's witnesses, he did not produce any witnesses of his own to impeach or rebut their testimony, nor did he offer additional evidence. Clearly, these omissions could have been rectified had counsel known that an 8(a)(1) issue was in the case. In asking the Board, and the Court, to find a violation not alleged or litigated, petitioner is at odds with settled judicial precedent precluding such finding,<sup>29</sup> with Section 5 of the Administrative

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<sup>28</sup> In fact, counsel for General Counsel disclaimed any intent to prove a Section 8(a)(1) violation (Tr. 36-38, 114). See *I.U.E. v. N.L.R.B.*, 289 F. 2d 757 (C.A.D.C.). Union's counsel did not give the slightest indication that it was seeking to prove an 8(a)(1) violation until it submitted its brief to the Trial Examiner.

<sup>29</sup> *Douds v. International Longshoremen's Ass'n*, 241 F. 2d 278, 283 (C.A. 2). "The complaint, much like a pleading in a proceeding before a court, is designed to notify the adverse party of the claims that are to be adjudicated so that he may prepare his case, and to set a standard of relevance which shall govern the proceedings at the hearing." See also, *N.L.R.B. v. Bradley Washfountain Co.*, 192 F. 2d 144, 149 (C.A. 7); *N.L.R.B. v. E&B Brewing Co.*, 276 F. 2d 594, 598-599 (C.A. 6), cert. denied, 366 U.S. 908; *N.L.R.B. v. Johnson*, 322 F. 2d 216 (C.A. 6), cert. denied, 376 U.S. 951; *North-eastern Indiana Bldg. & Constr. Trades Council v. N.L.R.B.*, 352 F. 2d 696, 698-699 (C.A. D.C.) and cases cited at n. 4; *N.L.R.B. v. Majestic Weaving Co., Inc.*, 355 F. 2d 854 (C.A. 2).



Procedure Act (5 U.S.C. 1004),<sup>30</sup> with Section 10(b) of the NLRA,<sup>31</sup> and with Section 102.15 of the Board's Rules and Regulations.<sup>32</sup>

*Independent Metal Workers Union Local 1 (Hughes Tool Co.)*, 147 NLRB 1573, and *N.L.R.B. v. Puerto Rico Rayon Mills*, 293 F. 2d 941 (C.A. 1), relied upon by petitioner (Br. p. 18), are clearly distinguishable. In *Hughes*, both the Trial Examiner (at p. 1602) and the Board majority (at p. 1576) concluded that "where the complaint clearly describes an action which is alleged to constitute an unfair labor practice . . .," and the conduct alleged is fully litigated, the Board may find that it violates a section of the Act in addition to that alleged in the complaint, even though General Counsel had chosen "not to allege as a legal conclusion that the pleaded and litigated facts violate those [additional] sections of the Act." Similarly, in *Puerto Rico Rayon Mills*, *supra*, although the section of the Act which the Board found violated was not included in the complaint, the *conduct* which supported the Board's finding *was* alleged, and was fully

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<sup>30</sup> Section 5 provides, "In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing . . . (a) Persons entitled to notice of an agency hearing shall be timely informed of . . . (3) the matters of fact and law asserted."

<sup>31</sup> Section 10(b) refers to "a complaint stating the charges."

<sup>32</sup> Section 102.15 provides that a complaint must contain a "clear and concise description of the acts which are claimed to constitute unfair labor practices, including, where known, the approximate dates and places of such acts and the names of the respondent's agents or other representatives by whom committed."

litigated at the hearing. See also *N.L.R.B. v. H.E. Fletcher Co.*, 298 F. 2d 594, 600 (C.A. 1). Here, in contrast, the complaint alleged neither the conduct nor the section supposedly violated, and the issue was not fully litigated at the hearing.

In any event, it is clear that the employer's conduct at the picket line was neither in response to, nor directed against, the Union's organizational campaign and was not the kind of conduct designed to discourage his employees from joining the Union.<sup>33</sup> Rather the "threats"<sup>34</sup> were made in angry response to the picketing of the employer's premises with signs accusing him of unfair labor practices (Tr. 122), and to the success of the pickets who, on several occasions,

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<sup>33</sup> See cases cited, *supra*, n. 15.

<sup>34</sup> The threats of harm sometime in the future "after all this is over . . ." (Tr. 127), were obviously empty. Mrs. Walker, a picket who was threatened once in six weeks of picketing testified that she was "enjoying it very much," that she "didn't want to be rude and laugh in [manager Ackerson's] face" (Tr. 119), and just continued to picket. Another picket, Mrs. Bostick, was also threatened once during her shorter employment on the picket line (Tr. 110-116). A third picket, Joe Pimental, was threatened on several occasions by Serpa himself. The record shows that Serpa is a "little fellow of advanced age" (Tr. 129) with one arm (Tr. 128-129), who is "sick and can't work" (Tr. 50). Pimental is 34 years old, weighs 220 pounds and is six feet tall. Although Pimental testified to his belief that "all [Serpa's] strength is in that one hand" (Tr. 130), it is apparent that Pimental lacked Mrs. Walker's ability to place these incidents in perspective. Cf. *Drivers Union v. Meadowmoor Co.*, 312 U.S. 287, 293; *Free Play Togs, Inc.*, 140 NLRB 1428; *Twin Kee Mfg. Co.*, 130 NLRB 614. No attempt was ever made to carry out these threats (Tr. 116, 120).

turned away prospective customers and deliveries (Tr 113, 118-119, 122, 124, 126-127). Thus, it cannot be said that the employer's conduct in October and November shows that on September 25 he declined recognition because of anti-union animus, and that he then intended to undertake a course of conduct designed to undermine the Union.<sup>35</sup> As we have shown, *supra*, pp. 4-5, 11, Peri's attitude toward unionization was reflected in his "hands off" statements to the Union agents and the employees at the time of the Union's campaign, and his total lack of any campaign activity—legal or illegal—against the Union, even though he was told on September 16 that the Union intended to organize his salesmen.

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<sup>35</sup> The employer was well aware, at the time of these incidents, that a majority of the employees did not want the Union to represent them (R. 14; Tr. 145-146, R. Exh. 2, 3).

## CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition to review and set aside the Board's order should be denied.

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September 1966

## CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and in his opinion the tendered brief conforms to all requirements.

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MARCEL MALLET-PREVOST  
*Assistant General Counsel*  
*National Labor Relations Board*

## APPENDIX A

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

## RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a) (3).

## UNFAIR LABOR PRACTICES

Sec. 8(a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

\* \* \* \*

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a).

\* \* \* \*

## REPRESENTATIVES AND ELECTIONS

Sec. 9(a) Representatives designated or selected for the purposes of collective bargaining by the ma-

jority of the employees in a unit appropriate for such purposes, shall be the exclusive representatives of all the employees in such unit for the purposes of collective bargaining in respect to rates of pay, wages, hours of employment, or other conditions of employment . . .

\*       \*       \*       \*

(c) (1) Whenever a petition shall have been filed, in accordance with such regulations as may be prescribed by the Board—

(A) by an employee or group of employees or any individual or labor organization acting in their behalf alleging that a substantial number of employees (i) wish to be represented for collective bargaining and that their employer declines to recognize their representative as the representative defined in section 9(a), or (ii) assert that the individual or labor organization, which has been certified or is being currently recognized by their employer as the bargaining representative, is no longer a representative as defined in section 9(a); or

(B) by an employer, alleging that one or more individuals or labor organizations have presented to him a claim to be recognized as the representative defined in section 9(a);

the Board shall investigate such petition and if it has reasonable cause to believe that a question of representation affecting commerce exists shall provide for an appropriate hearing upon due notice. Such hearing may be conducted by an officer or employee of the regional office, who shall not make any recommendations with respect thereto. If the Board finds upon the record of such hearing that such a question of rep-



resentation exists, it shall direct an election by secret ballot and shall certify the results thereof.

\* \* \* \*

(5) In determining whether a unit is appropriate for the purposes specified in subsection (b) the extent to which the employees have organized shall not be controlling.

\* \* \* \*

### PREVENTION OF UNFAIR LABOR PRACTICES

Sec. 10(b) Whenever it is charged that any person has engaged in or is engaging in any such unfair labor practice, the Board, or any agent or agency designated by the Board for such purposes, shall have power to issue and cause to be served upon such person a complaint stating the charges in that respect, and containing a notice of hearing before the Board or a member thereof, or before a designated agent or agency, at a place therein fixed, not less than five days after the serving of said complaint . . .

(c) \* \* \* If upon the preponderance of the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act:

\* \* \*

\* \* \* \*

(e) The Board shall have power to petition any court of appeals of the United States, . . . within any circuit . . . wherein the unfair labor practice in ques-

tion occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the hearing before the Board, its member, agent, or agency, the court may order such additional evidence to be taken before the Board, its member, agent, or agency, and to be made a part of the record . . . . Upon the filing of the record with it, the justification of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the . . . Supreme Court of the United States upon writ of certiorari or certification as provided in section 1254 of title 28.

(f) Any person aggrieved by a final order of the Board granting or denying in whole or in part of relief sought may obtain a review of such order in any circuit court of appeals of the United States in the circuit wherein the unfair labor practice in question was alleged to have been engaged in or wherein such person resides or transacts business, or in the United States Court of Appeals for the District of Columbia, by filing in such court a written petition praying that the order of the Board be modified or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Board, and thereupon the aggrieved party shall file in the court the record in the proceeding, certified by the Board, as provided in Section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall proceed in the same manner as in the case of an application by the Board under subsection (e) of this section, and shall have the same jurisdiction to grant to the Board such temporary relief or restraining order as it deems just and proper, and in like manner to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board; the findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall in like manner be conclusive.

\* \* \* \*

No. 20,781

IN THE

United States Court of Appeals  
For the Ninth Circuit

---

RETAIL CLERKS UNION, LOCAL NO. 1179,  
RETAIL CLERKS INTERNATIONAL ASSO-  
CIATION, AFL-CIO,

*Petitioner,*

VS.

NATIONAL LABOR RELATIONS BOARD,

*Respondent.*

On Petition to Review, Modify and Set Aside an Order  
of the National Labor Relations Board

REPLY BRIEF FOR PETITIONER

---

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**On Petition to Review, Modify and Set Aside an Order  
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**REPLY BRIEF FOR PETITIONER**

---

In view of certain statements made by Respondent in its counterstatement of the case which result in distortion of the pertinent facts, Petitioner desires to emphasize and place in proper perspective certain facts which have a critical bearing upon the resolution of the issue on appeal which is whether there is substantial evidence to support Respondent NLRB's finding—contrary to the finding of the Trial Examiner who heard the case—that the Employer in bad faith declined to recognize and bargain with the Union.

Thus, although Respondent, in its brief, characterizes Mr. Peri, who owns fifty per cent of the shares of the employer corporation and who is the general manager thereof, as completely inexperienced in labor relations and, therefore, impliedly oblivious to the realities of the meeting at which Petitioner demanded recognition as the representative of the Employer's sales personnel, the conclusion is inescapable that Peri was in fact well prepared for Petitioner's visit.

Peri knew that for ten days prior to the meeting of September 25, 1964, at which Petitioner's representatives made their demand for recognition, Petitioner had been picketing the premises of the Employer (R. Vol. 1-B, p. 143). Subsequent to his knowledge of the picketing, *and in direct consequence of it*, Peri, who Respondent implies had no idea what was going on when Petitioner presented him with its demand for recognition, in fact, had had meetings and conferences with representatives of the employer association which represented *John P. Serpa, Inc.* in labor relations with other unions (R. Vol. 1-A, p. 10; R. Vol. 1-B, pp. 169, 170.) Grudging admissions by Peri on cross-examination reveal that these meetings concerned discussions at length about the Petitioner's organizational activities and establish that Peri had knowledge, forewarning and ample preparation as to Petitioner's organizational purpose. Peri also admits that between the time the picketing commenced and the time of the demand he discussed the picketing with Union agents Paddock and Atkinson (R. Vol. 1-B, pp. 168, 169).

Thus, on September 25, 1964 the Petitioner's officials met with a well prepared Peri. The demand for recognition of the Petitioner as the collective bargaining representative of the sales employees was made, and the signed authorization cards of a majority of these employees were given to Peri for his inspection. The record is clear that Peri *carefully* examined these cards (contrary to Respondent's assertion that Peri only "glanced briefly" at them—Respondent's Brief, p. 3), and admitted that the cards contained the signatures of all of his salesmen except Freitas and Davis (R. Vol. 1-A, p. 18; Vol. 1-B, p. 158). He had the option of checking them against his payroll records (R. Vol. 1-A, pp. 83-84) or having a third party check them (R. Vol. 1-A, pp. 28-29), but only seven familiar employees were involved. The cards were valid, and Peri knew that he had been presented with evidence which he had no reason to doubt and which established that five of his seven employees wanted the Union to represent them. In sum, Peri accepted the fact that he had been presented with valid authorization cards signed by five of his seven employees. In fact, Peri never, at any time—not even during the Hearing—attempted to deny the fact that he had no doubt on September 25, 1964 that the Petitioner did in fact represent a majority of his sales employees.

When Peri pleaded ignorance as to what Petitioner wanted by its demand for recognition, Roddick suggested that Peri then and there call Peri's lawyer.

Peri said that he could not reach his lawyer so late in the day (it was almost 6:00 P.M.), and told Roddick that he could “probably get him tomorrow” (R. Vol. 1-A, p. 20). Roddick gave Peri his business card and wrote on it Roddick’s home phone number so that Peri could reach him over the weekend. In spite of this unequivocal continuing demand for recognition and the continuation of the picketing, Peri never again communicated with Roddick or any other of Petitioner’s officials, except that he told one of the Petitioner’s business agents some five days later that he would *never* sign a recognition agreement with Petitioner (R. Vol. 1-A, p. 74).

The Trial Examiner, upon hearing all the evidence in proceedings before him, and personally observing the demeanor and other indications of credibility of the witnesses, concluded that the employer did not have a good faith doubt of the Petitioner’s majority status at the time of Petitioner’s demand for recognition on September 25, 1964, and apparently just “clung to the hope that the Union would just go away” (R. Vol. 1, p. 16).

In its brief the Respondent repeats the language of the Board’s decision to the effect that the Board adopted the “fact findings, credibility resolutions and conclusion of the Trial Examiner” (Respondent’s Brief, p. 6). It is respectfully submitted that if the fact findings and credibility resolutions of the Trial Examiner are adopted, the refusal to bargain charge must be upheld.

This failure to *in fact* give proper weight to the Trial Examiner's findings of fact and credibility resolutions constitutes the defective foundation for Respondent's entire argument. Respondent advances three contentions in its attempt to avoid the simple and direct fact that its Trial Examiner who observed the witnesses concluded that Peri did not have a good faith doubt as to the Union's majority status.

First, Respondent attempts to bury under misleading citations the fact that this Court has properly and accurately stated its function upon review of Decisions and Orders of the National Labor Relations Board. Thus, in *Snow & Sons v. NLRB*, 134 NLRB 709, enf'd 308 F. 2d 687 (9th Cir., 1962), this Court clearly set forth the Supreme Court's *Universal Camera* criterion for review of an NLRB decision in which the Board does *not* agree with its Trial Examiner on issues of fact, and credibility. (See Petitioner's Opening Brief at pages 8 and 9.)

Respondent cites several decisions purportedly controlling on the question of review of Respondent's findings and conclusions on the issues of fact. Each case, however, has distinguishing features and none purport to change the landmark rule of *Universal Camera*.

Thus, in *International Woodworkers v. NLRB* (C.A.D.C.), 263 F. 2d 483, cited by Respondent at page seven of its brief, the court quotes the Supreme Court's decision in *NLRB v. Truitt Mfg. Co.*, 351 U.S. 149, as follows:



Each case must turn upon its particular facts. The inquiry must always be whether or not under the circumstances of the particular case the statutory obligation to bargain in good faith has been met. (263 F. 2d 483, 485.)

And, in *Oil Chemical & Atomic Workers v. NLRB*, ..... F. 2d ..... (C.A.D.C., 1966), 62 LRRM 2238, cited by Respondent at page seven of its brief in support of its findings and decision herein, the court pointed out in terms pertinent to the instant case as follows:

The Board cannot satisfy its statutory function merely by stating that it disagrees with a Trial Examiner. *It must make clear the basis of its disagreement.* Its decision must be presented in such form as to enable this Court to pass intelligently on that decision, and *to determine whether it is rationally related to findings and supported by substantial evidence.* *Retail Store Employees Union v. NLRB*, U.S. App. D.C. ...., ..... F. 2d ....., 59 LRRM 2763 (July 13, 1965). In our opinion the Board properly discharged this function. Its decision sets forth and makes clear that the Examiner's decision was given attentive consideration. . . . *It suffices that the Board addressed itself to key items of evidence which were crucial in terms of the Company's alleged status as employer, and fairly indicated the basis on which it was drawing inferences contrary to those of the Examiner.* (62 LRRM 2238, 2240; emphasis added.)

Under the *Universal Camera* rule and the above-quoted interpretations thereof, the Respondent's de-

termination herein that the General Counsel did not introduce "any evidence" whatever bearing on the lack of good faith of the Employer cannot be upheld.

Secondly, in its attempt to avoid coming to grips with the real issue as to the Trial Examiner's first-hand conclusion that Peri, in fact, had no good faith doubt, Respondent does this Court a disservice by interjecting an argument which can only be characterized as a "red herring".

Thus, Respondent, in its brief, by repeated allusions to the Employer Association (Respondent's Brief, pp. 2, 3, 5, and 11, and footnotes 2, 3, 4, 6 and 17) attempts to retroactively create a defense for the Employer to the effect that the Employer properly refused to recognize and bargain with Petitioner because Petitioner's demand was not for an appropriate unit. However, Peri did not raise the question of unit during the September 25, 1964 demand meeting. And the Employer itself later filed an RM petition with the NLRB, stating that a unit identical to the unit sought by Petitioner was the appropriate unit (R. Vol. 1-A, p. 8). Moreover, the fact that the unit sought by Petitioner is an appropriate unit was stipulated by the parties at the Hearing. Respondent's General Counsel in his brief to the Trial Examiner stated as follows:

Respondent stipulated that the unit set forth in Paragraph VI of the Complaint (G.C. Exhibit 1-c) is an appropriate unit (Tr. 7-8) and that the said unit, as of September 25, 1964, and at all times material to this case, consisted of

seven nonsupervisory employees, viz.: Hubert E. Lee; Joe T. Pace; Richard Stevens; W. H. "Wid" Hoskins, II; A. L. Bravo, Jr.; Joe Freitas; and John Davis (Tr. 11-12). There is no past history of bargaining for a unit of salesmen employed by the Respondent (Tr. 39, 49) or by any other member(s) of the Contra Costa Automotive Association. The Board has directly passed on this point, and has found the single-employer unit appropriate. See *Lownsbury Chevrolet Company*, 101 NLRB 1752, almost identical to the instant case on the facts. See also *Manhasset Motors, Inc.*, 137 NLRB 443, 445; *Weaver-Beatty Motor Co.*, 112 NLRB 60, 63.

And the Trial Examiner and the Board held that the unit sought by Petitioner was an appropriate unit (R. Vol. 1, p. 15 and R. Vol. 1, p. 23).

Respondent's third method of avoiding the significant fact as found by the Trial Examiner that Peri actually had no good faith doubt of the Union's majority status on September 25, 1964 consists of an attempt to distinguish between a third party card check and a direct, personal examination of the cards by the Employer.

Thus, Respondent, in its Brief, attempts to convince the Court that cards checked by a stranger against a payroll are somehow more "reliable" than cards examined by the boss himself. There is an obvious inconsistency when the Board which has repeatedly recognized and sanctioned card checks now argues that an examination "cannot, alone, indicate

the circumstances under which the signatures were solicited or obtained, or resolve the question whether the cards reliably express the employees' desire for representation." (Respondent's Brief, pp. 12-13.)

Because this case involved a direct examination of the cards by the boss and not a third party cross check, Respondent in its brief at page 13 states: "There is no evidence in this case that the employer had independent, reliable knowledge that the Union represented a majority of his employees when he declined recognition." (Respondent's Brief, p. 13.) That the fallaciousness of this attempt to distinguish between the reliability of a third party card check and a direct card check is known to Respondent itself is best exemplified by the Board's own language in *Jem Mfg. Co., Inc.*, 156 NLRB No. 62:

Ordinarily, the General Counsel sustains this burden of proof by demonstrating that an employer has engaged in other unfair labor practices which are designed to dissipate a union's majority status. However, an employer's bad faith may also be demonstrated by a course of conduct which does not constitute an independent unfair labor practice. Thus, in *Snow & Sons* the employer's objective of seeking delay and its rejection of the collective-bargaining concept was manifested when it repudiated a previously agreed upon card check indicating the union's majority status by continuing to insist on an election. Similarly, in *Kellogg Mills*, the Board found that the employer had manifested bad faith when, after a card check by a third party which established the union's majority and the actual

commencement of bargaining negotiations, the employer withdrew from negotiations and demanded an election upon the advice of newly hired counsel. The only relevant difference between *Kellogg Mills* and this case is that in the former a third person made the card check which satisfied the employer that the union represented a majority, whereas in this case the Employer himself examined the cards to determine the Union's majority. *This difference in the means of checking a union's majority is of no significance: an employer's check certainly is as reliable as that by a third party.* (Footnotes deleted; emphasis supplied.)

As its final position, Respondent argues that its General Counsel did not offer any evidence to demonstrate that the Employer's refusal to recognize the Union was based on bad faith. It is respectfully submitted that the Board is failing to give due weight to the Trial Examiner's conclusion, based on his first-hand appraisal of Peri, that Peri was not acting in good faith when he refused to extend recognition to the Union since he had no doubt as to the Union's majority status in an appropriate unit.

At the Hearing, Peri advanced various spurious reasons for his refusal to grant recognition. He deliberately feigned ignorance of what the demand meeting was all about and attempted to mislead as to his conversations with and attempts to contact his own attorneys. Only by a first-hand appraisal of Peri's direct testimony as compared to his vacillating and evasive replies to cross-examination, can a valid judg-



ment be made as to Peri's true reason for refusing to extend recognition.

The courts have repeatedly had occasion to remind the Board that there is no *per se* refusal to bargain, but that in each case the party's state of mind must be examined to see if he truly had a good faith doubt. The Trial Examiner, on the evidence before him, including the credibility determination as to Peri, was significantly informed to make a determination as to whether or not Peri, in fact, had a good faith doubt. The Trial Examiner concluded that Peri did not have a good faith doubt. The Board has not fairly indicated a basis to support the drawing of the contrary inference, nor has it given "attentive consideration" to the evidence supporting the Trial Examiner's finding.

Thus, this Employer was well prepared for the Union's demand for recognition. He carefully scrutinized the authorization cards and accepted their validity. He raised no question as to any doubt whatsoever of the Union's majority status in the appropriate unit. He declined to recognize the Union. He wanted time to consult his attorney. After consulting his attorney he still failed to extend recognition to the Union whose officials were awaiting his telephone call. At the NLRB hearing he suggested false and misleading reasons to disguise the plain fact that although he had no good faith doubt as to the Union's majority status in the appropriate unit, he continued to refuse to extend recognition to the Union.



In addition to the evidence discussed hereinabove, which is itself sufficient to require a reversal of the Respondent's decision and order, evidence was adduced at the Hearing with respect to incidents of Employer violence and threatened violence against Petitioner's pickets. Contrary to the assertion of Respondent (Respondent's Brief, pp. 20-24), these matters were fully litigated and do offer admissible, reinforcing evidence of the Employer's motivation, state of mind, and absence of good faith. *Bernel Foam Products Co.*, 146 NLRB 161; *Johnnie's Poultry Co.*, 146 NLRB 98. The fact that these incidents were not specifically alleged in the Complaint does not preclude a finding as to commission of these independent unfair labor practices within the meaning of Section 8(a)(1) of the Act. See *Frito Company v. NLRB* (9th Cir., 1964), 330 F. 2d 458; *Associated Home Builders of the Greater East Bay v. NLRB* (9th Cir., 1965), 352 F. 2d 745.

Thus, the totality of the evidence in this Record overwhelmingly supports the finding of the Trial Examiner that the Employer had no good faith doubt as to the Union's majority status when recognition was refused. Therefore, it is respectfully submitted that the Board erroneously dismissed the Complaint when it expressly determined that there was no evidence to support a finding of lack of good faith doubt on the part of the Employer.

The order of the Respondent should be set aside and the Respondent should be ordered by the Court to

find that the Employer violated Section 8(a)(5) of the Act when it refused to bargain with Petitioner upon request and to thereupon issue an order requiring the Employer to recognize and bargain with Petitioner.

Dated, San Francisco, California,  
October 17, 1966.

Respectfully submitted,

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**NATIONAL LABOR RELATIONS BOARD, PETITIONER**

*v.*

**LANE-COOS-CURRY-DOUGLAS COUNTIES BUILDING &  
CONSTRUCTION TRADES COUNCIL, RESPONDENT**

---

**On Petition for Enforcement of an Order of the  
National Labor Relations Board**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS  
BOARD**

---

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 20,783

NATIONAL LABOR RELATIONS BOARD, PETITIONER

*v.*

LANE-COOS-CURRY-DOUGLAS COUNTIES BUILDING &  
CONSTRUCTION TRADES COUNCIL, RESPONDENT

---

**On Petition for Enforcement of an Order of the  
National Labor Relations Board**

---

**BRIEF FOR THE NATIONAL LABOR RELATIONS  
BOARD**

---

**JURISDICTION**

This case is before the Court upon the petition of the National Labor Relations Board for enforcement of its order, issued against respondent on November 23, 1965, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*). The Board's decision and order (R. 24-28, 35-36)<sup>1</sup> are reported at

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<sup>1</sup> References to the formal documents reproduced as "Volume I, Pleadings" are designated "R."

155 NLRB No. 88. This Court has jurisdiction over the proceeding, the unfair labor practice having occurred at Eugene, Oregon, within this judicial circuit.

### STATEMENT OF THE CASE <sup>2</sup>

Willis Hill is a general contractor in the building and construction industry. In January 1965, Hill was engaged in the construction of a book store adjacent to the campus of the University of Oregon at Eugene. On this project, he employed carpenters and laborers who were members of AFL-CIO local unions affiliated with the respondent labor organization. Since January 5, 1965, respondent has demanded that Hill enter into and execute an agreement entitled "Oregon State Building and Construction Trades Council Articles of Agreement." Article IX of that agreement contains the following provision:

It is further agreed that no employees working under this Agreement need . . . cross any picket line or enter any premises at which there is a picket line authorized by the Council; or any other Building & Construction Trades Council or authorized by any Central Labor Council, or handle, transport or work upon or with any product declared unfair by any of such Councils.

On January 12 and 15, respondent threatened to picket Hill at the book store project unless he execut-

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<sup>2</sup> The facts in this case are undisputed. Before the Board, the parties stipulated that certain documents constituted the entire record, that no evidentiary hearing was necessary, and that the case could be submitted directly to a Trial Examiner for decision upon the stipulated record and briefs (R. 18).

ed the agreement. On January 18, respondent commenced picketing at the project, using picket signs which bore the following legend:

W. HILL JOB

Working Conditions Less Than  
 Enjoyed by Unions Affiliated With  
 LANE-COOS-CURRY-DOUGLAS COUNTIES  
 BUILDING & CONSTRUCTION TRADES COUNCIL  
 No Dispute With Any Other Contractor  
 Exists on This Job.

As a consequence of the picketing, Hill's employees and other employees have refused to work at the project.

On these facts, the Board concluded that respondent had violated Section 8(b)(4)(i)(ii)(A) by picketing with an object of forcing Hill to enter into an agreement prohibited by Section 8(e) of the Act. The Board's order requires respondent to cease and desist from engaging in a strike or picketing with an object of forcing Hill to enter into any agreement prohibited by Section 8(e), and to post an appropriate notice.

ARGUMENT

**The Board Properly Found That Respondent Violated Section 8(b)(4)(i)(ii)(A) Of The Act By Picketing To Compel Execution Of An Agreement Prohibited By Section 8(e)**

*A. The statutory provisions and their purpose*

The declared purpose of the secondary boycott provisions of the 1947 Taft-Hartley Act was to limit the

area of industrial dispute, in order to confine its effects to the parties immediately concerned, and to prevent its extension to employers and employees not directly involved.<sup>3</sup> As the Supreme Court pointed out, these provisions were aimed at "shielding unoffending employers and others from pressures in controversies not their own." *N.L.R.B. v. Denver Bldg. Trades Council*, 341 U.S. 675, 692. However, in the interval between the passage of the Taft-Hartley Act and the 1959 amendments, labor organizations resorted to tactics to circumvent the secondary boycott proscriptions by successfully exacting from employers so-called "hot cargo" agreements under which the employers relinquished their freedom to handle or provide goods and services for or to employers which the contracting union considered "unfair."<sup>4</sup> The Supreme Court in *Local 1976, United Brotherhood of Carpenters v. N.L.R.B. (Sand Door)*, 357 U.S. 93, held that such agreements were not illegal, pointing out that under the then-existing secondary boycott provisions contained in Section 8(b)(4), the legal prohibition was directed not at any contractual *agreement* entered into on the part of the employer, but

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<sup>3</sup> S. Rep. No. 105, 80th Cong., 1st Sess., pp. 8, 22, 54, 1 Leg. Hist. of Labor-Management Relations Act, 1947 (Gov't Print. Office, 1948) pp. 414, 428, 460 (hereafter referred to as "Leg. Hist. '47"); 2 Leg. Hist. '47, 1106.

<sup>4</sup> See, e.g., the analysis of the secondary boycott and "hot cargo" provisions in the 1959 amendments by Senator Kennedy and Congressman Thompson, II Legislative History of the Labor-Management Reporting and Disclosure Act of 1959 (Gov't Print. Office, 1959) 1707-1709 (hereafter, "Leg. Hist. '59").

only at union *inducement* of employees to refuse to handle goods.<sup>5</sup>

Cognizant of this "major weakness in the law against secondary boycotts" (II Leg. Hist. '59, 1708), Congress in the 1959 amendments undertook to close the "loopholes" which permitted labor organizations to circumvent these boycott provisions. *N.L.R.B. v. Servette, Inc.*, 377 U.S. 46. Thus, Section 8(e), added by the Landrum-Griffin Act, made unlawful "any contract or agreement, express or implied" whereby an employer agrees not to handle products of another employer or agrees to cease doing business with any other person. In addition, Congress amended Section 8(b)(4) to prohibit strikes or picketing designed to force an employer to enter into an agreement prohibited by Section 8(e).<sup>6</sup> The sole issue here

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<sup>5</sup> Thus, although the Supreme Court held that the execution of hot cargo agreements and voluntary compliance therewith by the employer were lawful, it also held that the inducement of employees to strike or refuse to handle "hot goods", with the object of forcing employers to abide by the hot cargo agreements, was unlawful. Such hot cargo agreements, the Court held, did not constitute a defense to the secondary boycott provisions. *Local 1976, supra*.

<sup>6</sup> The statutory language is:

Sec. 8(b) It shall be an unfair labor practice for a labor organization or its agents—

\* \* \* \*

(4) (i) to engage in, or to induce or encourage any individual employed by any person engaged in commerce or in an industry affecting commerce to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any serv-



is whether the Board properly found that Article IX is prohibited by Section 8(e) of the Act.

---

ices; or (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where in either case an object thereof is:

(A) forcing or requiring any employer or self-employed person to join any labor or employer organization or to enter into any agreement which is prohibited by section 8(e);

\* \* \* \*

Sec. 8(e) It shall be an unfair labor practice for any labor organization and any employer to enter into any contract or agreement, express or implied, whereby such employer ceases or refrains or agrees to cease or refrain from handling, using, selling, transporting or otherwise dealing in any of the products of any other employer, or to cease doing business with any other person, and any contract or agreement entered into heretofore or hereafter containing such an agreement shall be to such extent unenforceable and void: *Provided*, That nothing in this subsection (e) shall apply to an agreement between a labor organization and an employer in the construction industry relating to the contracting or subcontracting of work to be done at the site of the construction, alteration, painting, or repair of a building, structure, or other work: *Provided further*, That for the purposes of this subsection (e) and section 8(b) (4) (B) the terms "any employer", "any person engaged in commerce or an industry affecting commerce", and "any person" when used in relation to the terms "any other producer, processor or manufacturer," "any other employer", or "any other person" shall not include persons in the relation of a jobber, manufacturer, contractor, or subcontractor working on the goods or premises of the jobber or manufacturer or performing parts of an integrated process of production in the apparel and clothing industry: *Provided further*, That nothing in this Act shall prohibit the enforcement of any agreement which is within the foregoing exception.

**B. Article IX commits the signatory employer to a boycott of union-disfavored employers**

Article IX expressly permits employees of the signatory employer to refuse to "handle, transport or work upon or with any product declared unfair" by respondent or other named labor organizations (R. 26). This Court has already ruled that such an agreement violates Section 8(e) of the Act. *N.L.R.B. v. Joint Council of Teamsters No. 38*, 338 F. 2d 23, 31. Accord: *Truck Drivers Local 413 v. N.L.R.B.*, 334 F. 2d 539, 546-547 (C.A.D.C.) cert. denied, 379 U.S. 916; *Los Angeles Mailers Union v. N.L.R.B.*, 311 F. 2d 121, 124-25 (C.A.D.C.); *N.L.R.B. v. Amalgamated Lithographers*, 309 F. 2d 31, 36, 40-41 (C.A. 9), cert. denied, 372 U.S. 943; *Employing Lithographers v. N.L.R.B.*, 301 F. 2d 20, 28, 30 (C.A. 5).

In *Joint Council*, the agreement allowed employees not to work on goods coming from a struck plant; here the employees are allowed not to work on goods labelled unfair by the Union. This distinction is of no consequence for present purposes. See the legislative history summarized in *Truck Drivers Local 413*, *supra*, 334 F. 2d at 547. For, as the Court held in *Joint Council*, when the question of whether a boycott of some third party will be invoked "depends entirely upon the latter's relationship with the union . . . the thrust of this boycott agreement is secondary [and therefore prohibited]." 338 F. 2d at 28. Nor may the Act's reach be escaped merely because the clause is addressed to the employees' refusal to deal in "hot" products, while Section 8(e) is addressed to employer agreements to boycott: the employer func-

tions through his employees in this matter. *Los Angeles Mailers, supra*, 311 F. 2d at 124-125, *Joint Council, supra*, at 31.

The refusal to handle language of Article IX, therefore, of itself warrants enforcement of the Board's order. In addition, the Board also found the picket line clause of Article IX violative of Section 8(e).

**C. *The picket line protection of Article IX sanctions secondary strikes by the covered employees***

Article IX expressly allows all employees covered by the agreement to refuse to "cross any picket line or enter any premises at which there is a picket line authorized by the [respondent or other named labor organizations]" (R. 26). Like the refusal to handle clause discussed above, this provision also envisages and sanctions a boycott of union-disfavored employers. Accordingly, it too violates Section 8(e) of the Act.

The Board acknowledges that Congress did not intend, in enacting Section 8(e), to prohibit *all* contractual protection for employees who would refuse to cross picket lines. See *Drivers, Salesmen, etc., Local Union No. 695, IBT (Madison Employers' Council, etc.)*, 152 NLRB No. 55, pending review, Nos. 19,386 and 19,429 (C.A.D.C.). During consideration of the 1959 amendments, fears were voiced that the proposed ban on hot cargo clauses might be so construed. See I Leg. Hist. '59, 779; II Leg. Hist. '59, 1708 (2, 3). The Senate-House conferees agreed, however, that Section 8(e) was not intended to prohibit agreements sanctioning refusal to cross a lawful primary picket line. *Truck Drivers Local 413, supra*, 334 F.

2d 543-545. For an employee's refusal to cross a *primary* picket line constitutes lawful protected activity. *Teamsters, Chauffeurs and Helpers Local Union No. 79 v. N.L.R.B.*, 325 F. 2d 1011 (C.A.D.C.), cert. denied, 377 U.S. 905, affirming 137 NLRB 1545, 1547; *N.L.R.B. v. Cone Bros. Contracting Co.*, 317 F. 2d 3, 8 (C.A. 5), cert. denied, 375 U.S. 955; *N.L.R.B. v. John S. Swift Co.*, 277 F. 2d 641, 646 (C.A. 7); and see, *N.L.R.B. v. West Coast Casket Co.*, 205 F. 2d 902, 905 (C.A. 9). Since Section 8(e) is, as we have already shown (*supra*, pp. 3-5), designed to limit *secondary* activity, a provision in a bargaining contract which protects the exercise of protected *primary* conduct falls outside the intended reach of Section 8(e). *Truck Drivers Local 413, supra*, at 545.<sup>7</sup>

But refusal to cross a *secondary* picket line would itself be secondary conduct. To the extent a contract clause protects such conduct, it authorizes a secondary strike and is, to that extent, violative of Section 8(e). *Truck Drivers, Local 413, supra*, at 543. In the cited case, the clause permitted employees to refuse to cross "any" picket line. Here, the clause protects refusals to cross "any picket line authorized by the [respondent] Council; or any other Building and Construction Trades Council or authorized by any

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<sup>7</sup> In *Joint Council*, the Court was confronted by a contention that a certain contract provision, found unlawful by the Board, "should be read as if limited to a permissible agreement that employees will not be permitted to cross a picket line at the situs of a *primary* dispute" (338 F. 2d at 31, emphasis added). The Court did not consider this contention on its merits, since it was "not made before the Board, and comes too late" (*ibid.*).

Central Labor Council" (R. 26). The instant contract term is broad enough to cover an authorized secondary picket line and thus, no less than in *Truck Drivers Local 413, supra*, it would permit employees to engage in secondary activity.

Thus, the contract here permits covered employees to refuse to deal with a neutral employer whose premises have been subjected to a picket line "authorized" by the respondent. The picketing may itself be unlawful, aimed merely at disrupting the neutral's dealings with another employer. Yet, if this contract were permitted to operate, respondent's "authorization" would deprive the signatory employer of power to continue business dealings with that neutral employer.

Respondent argued, before the Board, that the Board should not presume an illegal object here merely because the contract's draftsman omitted language which would confine the picket line clause to a permissible scope (R. 32-34). There is no merit to this contention.

Cases like *N.L.R.B. v. Mountain Pacific Chapter, AGC*, 270 F. 2d 425 (C.A. 9), cited by respondent, are inapplicable here because they deal with Section 8(a)(3) where *actual motivation* is generally the target of inquiry. See *Local 357 Teamsters v. N.L.R.B.*, 365 U.S. 667; *American Ship Building Co. v. N.L.R.B.*, 380 U.S. 300, 311-313. Here, on the other hand, we deal with Section 8(e) where actual motive becomes irrelevant once the prohibited agreement is made: "the contract must be tested by its terms." *Truck Drivers Local 413*, 334 F. 2d at 542;



*Meat Drivers Union, Local 710 v. N.L.R.B. (Wilson & Co.)*, 335 F. 2d 709, 716 (C.A.D.C.). Respondent does not dispute that the *terms* of this contract cover secondary conduct, as well as primary. Thus, the Board's decision here does not rest upon any presumptions about the motives of the contracting parties. Rather, the Board's approach here merely reflects what Congress decided in 1959: hot cargo clauses, by their very existence, inhibit a signatory employer's freedom of choice. *Los Angeles Mailers, supra*, 311 F. 2d at 123-124.

For Congress determined that the psychological and social pressures flowing from the employer's mere act of signature—what Senator McClellan described as “moral suasion” (II Leg. Hist. '59, 1007)—should be prohibited.<sup>8</sup> Of course, as respondent argued before the Board (R. 34), any subsequent enforcement of the contract in an unlawful manner could be found unlawful, too. But this does not suggest that the contract itself ought to be privileged. Section 8(e) prohibits “certain contract terms” and makes proof of subsequent implementation superfluous; indeed, such proof may show a separate, additional violation. *Los Angeles Mailers, supra*, 311 F. 2d at 123.

Respondent complains (R. 33) that it is thus subjected to rigid and technical scrutiny of its contract

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<sup>8</sup> See *Joint Council, supra*, 338 F. 2d at 28: “Section 8(e) forbids the agreement itself ‘whether activated or in suspense.’” See also the Kennedy-Thompson analysis of the Landrum-Griffin bill (II Leg. Hist. '59 1706, 1708) and the comments of Senator Goldwater (*id.* at 1843, 1857, 1824, 1829) to the same effect.



draftsmanship. As already shown, this complaint is better addressed to Congress. Besides, it has a hollow sound here, since respondent could probably satisfy the terms of the Board's order, with respect to this portion of Article IX, by simply inserting a single modifying word—"primary"—in its proposed contract. For the Board found this picket line clause violative of Section 8(e) only to the extent it applies to secondary picket lines (R. 27).<sup>9</sup> And in deference to the remedial policy of Section 8(e), the Board was surely warranted in declining to rewrite respondent's proposed contract to supply the crucial distinction between secondary and primary activity which it ignored.

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<sup>9</sup> Accord: *Drivers, Salesmen, etc., Local Union No. 695, IBT (Madison Employers' Council, etc.)*, 152 NLRB No. 55; *Los Angeles Building & Construction Trades Council (Portofino Marina)*, 150 NLRB No. 152; *Cement Masons Local Union No. 97 (Interstate Employers)*, 149 NLRB 1127.

## CONCLUSION

For the reasons stated, it is respectfully submitted that the Board's petition for enforcement of its order should be granted, and that a decree should issue enforcing said order in full.

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May 1966.

## CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court, and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST  
*Assistant General Counsel*  
*National Labor Relations Board*



No. 20783

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**United States**  
**COURT OF APPEALS**  
**for the Ninth Circuit**

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NATIONAL LABOR RELATIONS BOARD,  
*Petitioner,*  
v.

LANE-COOS-CURRY-DOUGLAS COUNTIES  
BUILDING & CONSTRUCTION TRADES  
COUNCIL,  
*Respondent.*

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**BRIEF OF RESPONDENT**

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*On Petition for Enforcement of an Order  
of the National Labor Relations Board*

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FILED

JUN 13 1966

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BUILDING & CONSTRUCTION TRADES  
COUNCIL,  
*Respondent.*

---

**BRIEF OF RESPONDENT**

---

*On Petition for Enforcement of an Order  
of the National Labor Relations Board*

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**STATEMENT OF THE CASE**

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Respondent agrees with and accepts the Board's statement of the case, except that the statement should have contained a full quotation of Article I of the proposed Oregon State Building and Construction Trades Council Agreement, which quotation is here provided:

"This agreement shall apply to and cover all building and construction work performed by the Employer, Developer and/or Owner-Builder within

the jurisdiction of any Union affiliated with the Council and the contracting or sub-contracting of work to be done at the site of the construction, alteration, painting, repair or demolition of a building, structure or other work." (Emphasis appears in the original contract.)

## ISSUE

The position of the petitioning National Labor Relations Board (hereinafter called the "Board") has been stated many times, e.g., *Los Angeles Building & Construction Trades Council (Portofino Marina)*, 150 NLRB 152 (1965); *Los Angeles Building & Construction Trades Council (Couch Electric Company, Inc.)*, 151 NLRB 46 (1965): Contract clauses insofar as they provide that no employee need cross a picket line, violate Section 8(e) of the National Labor Relations Act, as amended, "since the clauses in their broad scope can be read as applying to unlawful secondary picketing;" and contract clauses which provide that an employee need not handle unfair goods "is but another sanction made available to the respondent to enforce the unlawful clauses of its agreements."

Section 8(e) makes it an unfair labor practice to enter into a labor contract wherein the employer agrees to refrain from using the products of or to cease doing business with another person. Generally, however, Section 8(e) exempts contracts in the construction industry from the proscriptions of Section 8(e).<sup>1</sup>

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<sup>1</sup> See the Board's opening brief at pages 6-7 for the full text of Section 8(e) and Section 8(b)(4)(A). 29 U.S.C. § 158.

Article IX of the contract in question in this case would permit employees to refuse to "cross any picket line" or to "handle any product declared unfair."<sup>2</sup>

The Board concedes that the above clauses would be perfectly valid if they contained, for instance, limiting adjectives or clauses: e.g., "cross any *legal* picket line" or "handle any product declared unfair *provided such refusal to handle is legal*."

But, says the Board, without such limitation they could conceivably authorize secondary activity and permit economic coercion to enforce the secondary provisions. Consequently, the Board held Article IX to be in violation of Section 8(e) and thereby held respondent's picketing to obtain such a contract to be a violation of Section 8(b)(4)(A) of the Act.<sup>3</sup>

If there were no Section 8(e), there would be no violation. Thus, the principal issue is simply: Does Article IX, read in conjunction with the entire proposed contract (particularly Article I), violate Section 8(e)?

This issue can be further narrowed: Does the construction industry proviso apply to the contract in question? If it does, then Section 8(e) does not apply; and if Section 8(e) does not apply, then there can be no violation of Section 8(b)(4)(A) which only prevents picketing to obtain contracts in violation of Section 8(e).

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<sup>2</sup> See the Board's opening brief at page 2 for the pertinent text of Article IX of the contract in question.

<sup>3</sup> There is no evidence of existing and identifiable sub-contractors on the picketed job site, so that there can be and is no charge of an unfair labor practice under Section 8(b)(4)(B) of the Act as was found in *Building and Construction Trades Council of Orange County (Sullivan Electric Co.)*, 157 NLRB 25 (1966).



A collateral issue is: Is it proper for the Board to presume an illegal intent from the wording of Article IX of the contract simply because the contract does not contain language prohibitory of illegal action?

## ARGUMENT

### 1. A History of the Board's Position Regarding Hot-Cargo Clauses.

The history of the Board's position regarding "hot-cargo" provisions<sup>4</sup> is interesting as well as informative in dealing with the issue in this case.

In 1949, the Board's position was that Section 8(b)(4)(A) is not violated by a hot-cargo clause in the contract, that such clauses were permissible inasmuch as the employer had acquiesced. *International Brotherhood of Teamsters (Conway Express)*, 87 NLRB 972 (1949).

In 1954, the Board changed its position, overruled *Conway*, and held that hot-cargo clauses were a nullity and no defense to a Section 8(b)(4)(A) charge. *Inter-*

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<sup>4</sup> Here we use the term *hot-cargo clause* in the general sense of applying to all contract clauses which are an agreement to refrain from handling products of other employers or to cease doing business with other persons. Many of the cases wherein the Board has been previously overruled on the issue of obtaining hot-cargo clauses have involved so-called "sub-contractor clauses" wherein generally the employer agrees to either hire only union sub-contractors or to insure that all union wages, hours and conditions will be observed by his sub-contractors. In the case at bar the clauses in question are not subcontractor clauses, but this factual distinction is not apposite here. The sub-contractor clause cases are germane here, for no matter what the nature of the clause, the point is that the Board attacks it as being a violation of Section 8(e), that is, attacks it as being an agreement to refrain from handling products of other employers or to cease doing business with other persons.

*national Brotherhood of Teamsters (McAllister)*, 110 NLRB 1769 (1954).

In 1955, the Board reached still another position when it held that hot-cargo clauses are permissible in contracts but that any direct attempt by the union to induce the employees to observe the hot-cargo clause violated Section 8(b)(4)(A), even if the employer consented to the inducement. *Local 1976, United Brotherhood of Carpenters (Sand Door)*, 113 NLRB 1210 (1955).

In 1957, the Board went further and implied that the mere existence of a hot-cargo clause in a contract would constitute a presumption of inducement in violation of Section 8(b)(4)(A). *Truck Drivers Union (Genuine Parts Co.)*, 119 NLRB 53 (1957).

Then, in 1958, the United States Supreme Court in *Local 1976, Carpenters v. NLRB*, 357 U.S. 93 (1958) (the celebrated "Sand Door" decision) held that the Federal Labor Statutes do not, in any way, proscribe against labor-management hot-cargo agreements, although it would be an unfair labor practice to strike or use economic coercion to enforce such a clause once it had been obtained.

Then in 1959, Congress enacted the Labor-Management Reporting and Disclosure Act which included the passage of Section 8(e). In short, Section 8(e) disallows hot-cargo clauses and makes them null and void. Section 8(b)(4)(A) was, at that time, amended also to preclude unions from striking or using economic coercion to obtain clauses prohibited by Section 8(e). But

the new Section 8(e) also contained the construction industry proviso which, in general, exempted the construction industry from the proscriptions of Section 8(e) regarding the contracting of work at the site of the construction.

Following the 1959 amendments, the Board took the position that hot-cargo clauses were permitted in the construction industry when voluntarily made, but that the union could neither *picket to obtain* them, nor *picket to enforce* them. *E.g., Laborers Union Local 383 (Colson & Stevens Construction Co.)*, 137 NLRB 1650 (1962).

But the Federal Courts (including this Court) did not accept this interpretation of the new amendments and promptly reversed the Board in a number of instances, holding that the *Sand Door* precedent still applied and that, therefore, the construction industry proviso excludes on-site construction labor contracts from the effect of Section 8(e) and thereby from the effect of Section 8(b)(4)(A); thus it was permissible for the union to picket or to coerce to obtain hot-cargo provisions. *Laborers Union Local 383 v. NLRB*, 323 F.2d 422 (9th Circ. 1963) ("Colson & Stevens" decision); *Cuneo v. Carpenters District Council of Essex County and Vicinity*, 207 F. Supp. 932 (D.C.N.J. 1962); *LeBus v. Plumbers Local 60*, 193 F. Supp. 392 (E.D. La. 1961); *Essex County District Council of Carpenters v. NLRB*, 332 F.2d 636 (3d Circ. 1964); *Orange Belt District Council v. NLRB*, 328 F.2d 534 (D.C. Circ. 1964).

Following this Court's decision in *Colson & Stevens*,

the Board continued to follow its prior position and expressly and respectfully refused to follow this Court's holding. *Los Angeles Building & Construction Trades Council (Treasure Homes)*, 145 NLRB 34 (1963).

But then, in 1964, the Board reversed itself, decided to follow *Colson & Stevens* and allowed picketing to obtain *certain* on-site construction hot-cargo clauses. *Northeastern Indiana Building & Construction Trades Council (Centlivre Village Apartments)*, 148 NLRB 93 (1964).

The latest position of the Board, and apparently the one exerted in the case at bar, is that so-called sub-contractor clauses (a form of hot-cargo clause) in the construction industry are legitimate under the 8(e) proviso, but certain other broadly interpreted types of hot-cargo clauses are not legitimate under the proviso. Hot-cargo clauses such as are involved in the case at bar are deemed prohibited by Section 8(e) because they attempt to allow what 8(b)(4)(B) disallows; *i.e.*, such clauses attempt to permit the union *to enforce* the hot-cargo clauses. See *Muskegon Brick Layers Union (Greater Muskegon General Contractors Association)*, 152 NLRB 38 (1965); *Southern California District Council of Hod Carriers (Swimming Pool Gunnite Contractors Group)*, 158 NLRB 28 (1966).<sup>5</sup>

In other words, the Board today is apparently saying that the picket line clause and the unfair goods clause in the case at bar are tantamount to an agree-

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<sup>5</sup> Respondent commends to the Court the reading of Board Member Fanning's dissent in the *Muskegon* case.

ment to allow the union to use economic coercion *to enforce* the hot-cargo or sub-contractor clauses of the contract and are, therefore, a violation of Section 8(e) and Section 8(b)(4)(A). This is a new and unique approach to an area of construction hot-cargo clauses. It culminates a long line of varied positions by the Board and provides the latest quilt patch to what the United States Supreme Court has called a "checkered career."<sup>6</sup>

Respondents would urge that this latest position is nothing more than a disguised continuance of the Board's previous arguments as made in the *Sand Door* and *Colson & Stevens* cases.

## 2. The Legislative Policy and Spirit Underlying the Construction Industry Proviso.

Section 8(e) and its construction industry proviso were passed by the United States Congress principally to curtail certain labor management happenings in the transportation industry. The Legislature was, at all times, sympathetic with the traditional attitude of construction workers to refuse to work with and alongside of non-union products and workers.

In discussing the construction industry exemption to Section 8(e), it has been said:

"[W]e note that the unions in the trucking industry were the prime target of congressional concern." *Teamsters, Local 413 v. NLRB*, 334 F.2d 539, 549, (DC Circ. 1964). *Accord, NLRB v. Servette, Inc.*, 377 U.S. 46, 55 (1964).

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<sup>6</sup> *Local 1976, Carpenters v. NLRB*, 357 U.S. 93, 101 (1958).



In *Essex County District Council of Carpenters v. NLRB*, 332 F.2d 636 (3d Circ. 1964), the Court states:

"This limited exemption was granted apparently in recognition of problems peculiar to the construction industry, particularly those resulting from sporadic work stoppages occasioned by the traditional refusal of craft unionists to work alongside non-union men on the same project. The exemption does not extend to other agreements, such as those relating to subcontracts for supplies and materials to be transported to and delivered on the construction site." *Id.* at 640.

The most recent decision in this area is *Teamsters Local 695 v. NLRB*, — F.2d —, 53 CCH Labor Cases ¶ 11,217 (D.C. Circ. May 6, 1966). There the Court held that a picket line provision, such as in the case at bar was violative of Section 8(e) insofar as it applies to secondary activity. But here again, just as in all of the principal Court cases relied on by the Board and Intervenor in their briefs,<sup>7</sup> the case did not involve the construction industry proviso. It was argued by the union in *Teamsters Local 695* that it was involved in on-site construction and that therefore the proviso should ap-

<sup>7</sup> The cases cited and heavily relied on by the Board and Intervenor all concern the non-construction industries and all fall outside of the Section 8(e) proviso, e.g.: *L. A. Mailers Union v. NLRB*, 311 F.2d 121 (D.C. Circ.); *NLRB v. Amal. Lithographers*, 309 F.2d 31 (9th Circ.); *NLRB v. Joint Council of Teamsters No. 8*, 338 F.2d 23 (9th Circ.); *NLRB v. Teamsters Local 294*, 342 F.2d 18 (2d Circ. 1965); *Truck Drivers Local 413 v. NLRB*, 334 F.2d 539 (D.C. Circ. 1964). The more relevant line of case precedent would be those cases which deal with hot-cargo clauses in the construction industry, e.g., *Local 1976, Carpenters v. NLRB*, 357 U.S. 93 (1958); *Laborers Union Local 383 v. NLRB*, 323 F.2d 22 (9th Circ. 1963); *Essex County District Council of Carpenters v. N.L.R.B.*, 332 F.2d 636 (3d Circ. 1964).



ply. The Court rejected this argument inasmuch as the supposed on-site work was merely the delivery and pouring of concrete at the site. The Court went on to say:

“The importance of this distinction [the distinction of excepting on-site construction work from Section 8(e)] is that the purpose of the Section 8(e) proviso was to alleviate the frictions that may arise when union men work continuously alongside non-union men on the same construction site.” *Id.* at —

### **3. The Proviso Applies to the Facts of this Case and Thereby the Proscriptions of Section 8(e) Do Not Apply.**

Section 8(e) does not apply to the contract in question inasmuch as the construction industry proviso of Section 8(e) saves and excepts on-site construction industry from the effect of Section 8(e).

There should be no doubt that the industry here involved is construction. As such, this contract comes within the exception stated in Section 8(e):

“*Provided*, That nothing in this subsection (e) shall apply to an agreement between a labor organization and an employer in the construction industry relating to the contracting or subcontracting of work to be done at the site of the construction, alteration, painting, or repair of a building, structure, or other work: \* \* \*

There should also be no doubt that the contract in question is limited to on-site construction. Article I of the contract in question states in part:

“This Agreement shall apply to \* \* \* the con-

tracting or subcontracting of work to be done at the site of the construction, alteration, painting, repair or demolition of a building, structure or other work." (Emphasis appears in the original contract.)

The reader will quickly discern that the drafter of Article I has virtually copied the language of the Section 8(e) proviso, has intentionally placed it at the commencement of the contract terms, and has deliberately underscored its *on-site* application. It seems patently clear, therefore, that a reading of the *whole* agreement and not just a part thereof, would put the contract and Article IX thereof squarely within the construction industry proviso. Thus, Section 8(e) does not apply and respondent is permitted to picket to obtain this contract as written.

In *Los Angeles Building & Construction Trades Council (Couch Electric Co.)*, 151 NLRB 46 (1965), there was a similar introductory clause such as Article I in this case. But the Board in deciding that case apparently ignored it, and the opinion reflects that the issue was never raised. Respondent believes that the issue was ignored simply because, as we understand the Board's position, it makes no difference to the Board if the contract is limited to on-site construction. In the recent case of *Los Angeles Building & Construction Trades Council (Fowler-Kenworthy Electric Co.)*, 151 NLRB 83 (1965), General Counsel for the Board argued the same position that the Intervenor in this case now contends, that is, that the clause in question was not expressly restricted to on-site construction work and

therefore did not come within the construction industry proviso. The Board rejected this argument saying:

“As the General Counsel sees it, the ‘vice’ in Article IV lies in its reference to ‘all the work performed by said sub-contractor’ and in its failure expressly to confine the coverage of that phrase to on-site work. It is on this basis alone that the General Counsel would read into the Article by implication a purpose to include off-site as well as on-site work within the scope of its coverage. We are not persuaded, however, that in the circumstances of this case such a construction is necessarily or even reasonably required. Other terms of the same Article reflect an intent to confine the work covered by the quoted phrase to such work only as falls within the work jurisdiction of unions affiliated with the Building and Construction Trades Councils in the geographical area. There is nothing in this record to show that the work jurisdiction of any such union includes off-site work. Nor does it appear that Alexander, a general contractor in the construction industry, ever undertakes or subcontracts work to be done off-site. The only evidence presented in this proceeding concerning work undertaken or subcontracted by Alexander relates to work that was to be performed at a construction site.”

Thus, we understand the Board’s position to be that even though the clauses of Article IX are effectively limited to on-site construction, they are nevertheless in violation of Section 8(e) because under a broad interpretation they could conceivably authorize secondary activity and because they could conceivably be another sanction made available to respondent to enforce secondary provisions of the contract.

#### 4. In the Absence of the Section 8(e) Proscriptions, the Law Permits the Picketing to Obtain the Clauses in Question.

If the clauses of Article IX violate the Act, they violate it because Section 8(e), and *only* Section 8(e), proscribes against them. Indeed, this is what the Board found and ruled. Without Section 8(e), there is no other statutory proscription against such a clause. Thus, under the facts of this case, it is permissible, and not an unfair labor practice for the Respondent and the Intervenor to enter into any kind of a contract wherein the effect is to permit the non-handling of products of another employer or the cessation of business with another person.

In *District Council of Carpenters v. NLRB*, 332 F.2d 636 (3d Circ. 1964), the union picketed to obtain a contract containing a so-called "non-union condition" provision which permitted employees to refuse to work on any construction work at the job site where there are non-union employees. The NLRB held this to be in violation of Section 8(b)(4)(A) inasmuch as the clause violated Section 8(e). However, the Third Circuit denied enforcement of the Board's order. The Court reasoned, just as respondents argue here, that the construction industry exemption to Section 8(e) applies, therefore the proscriptions of Section 8(e) do not apply: Ergo, the union can picket to obtain such a clause.

Likewise, the United States Supreme Court in the *Sand Door* case<sup>8</sup> was presented with a proposed contract clause, *inter alia*, which stated that "workmen shall not

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<sup>8</sup> *Supra* at Footnote 6.

be required to handle non-union material." The ruling of the United States Supreme Court is well known; Unions can picket to obtain such a clause. The effect of the 1959 amendments on the *Sand Door* case has only been to curtail this holding in the non-construction and non-garment industries.

Without the application of the Section 8(e) proscriptions, the U. S. Supreme Court has also held that a union and an employer could agree that employees have a right to refuse to cross a picket line. *NLRB v. Rockaway News Supply Co.*, 345 U.S. 71 (1953).

And this Court in *Laborers Union Local 383 v. NLRB*, 323 F.2d 422 (9th Circ. 1963) (The "*Colson & Stevens*" case) in refusing to enforce the Board's order that a proposed contract clause violated Section 8(e), stated:

"Picketing to secure an agreement to cease doing business with certain persons is not made unlawful by [Section 8 (b) (4) (A)] where that agreement is within the construction industry proviso of Section 8(e)." *Id.* at 426.

It has always been the undoubted right of employees to refuse to cross *primary* picket lines. This was true before the 1959 amendments; it was affirmed in the 1959 amendments<sup>9</sup>; and it is true now. See *Teamsters Local 413 v. NLRB*, 334 F.2d 539, 543-44, (DC Circ. 1964). Hence, there has always been the right of the union and the employer to so agree in their labor contracts. The passage of Section 8(e) and its construction

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<sup>9</sup> See the proviso to 8(b)(4)(B).



industry proviso has absolutely nothing to do with the crossing of *primary* picket lines or with contracts in regard thereto. *Orange Belt District Council v. NLRB*, 328 F.2d 534 (DC Circ. 1964). On the contrary, Section 8(e) concerns itself only with *secondary* activities. When the construction industry proviso excepts that industry from the effect of Section 8(e), it means that contracts regarding on-site secondary activities are permitted in the construction industry. Hence, even if it could be conceivably demonstrated that Article IX in this case was intended to apply to *secondary* picket lines, it would not be an unfair labor practice until the union attempted to enforce such an agreed clause by economic pressure on the employer.

Of course, it was certainly *not* the intention of the drafters of Article IX to authorize illegal conduct and that fact may be legally presumed. On the contrary, the intent of the clause was to make clear to signatory employers that employees had the right to refuse to cross picket lines which, of course, have been legally constituted. The clause does not contemplate the illegality of a secondary picket line, nor does it contemplate the illegality of employees refusing to cross that secondary picket line, nor does it contemplate the illegality of economic coercion to enforce any activity proscribed by 8(b)(4)(B).

## 5. The Collateral Issue.

The Board concedes that the clauses would be proper if they had contained limiting adjectives or clauses, e.g.,



“cross any *legal* picket line” or “handle any product declared unfair *provided such refusal to handle is legal.*”

Respondent is somewhat frustrated and mystified to find that an unfair labor practice has been charged and found simply on the basis of a missing limiting adjective or to find that agreements can be legal only if they are expressly modified by the word “legal.” In *NLRB v. Mountain Pacific Chapter, AGC*, 270 F.2d 425 (9th Cir. 1959), this Court said that a provision in a labor contract requiring an employer to exclusively use the union hiring hall is not on its face illegal merely by its failure to contain language guaranteeing non-discriminatory hiring.

“It is apparent, then, that a contract which contains discriminatory provisions is illegal per se. It is also patent that a contract which is fair on its face is not unlawful in and of itself simply because it does not contain clauses prohibitory of illegal action.” *Id.* at 421.

The Board’s attempt here to write the contract of the parties is too technical. Collective bargaining contracts are not to be so rigidly construed. In speaking of such contracts, the United States Supreme Court has said:

“It is more than a contract; it is a generalized code to govern a myriad of cases which the draftsmen cannot wholly anticipate. \* \* \* ‘There are too many people, too many problems, too many unforeseeable contingencies to make the words of the contract the exclusive source of rights and duties.’” *Steelworkers v. Warrior & Gulf Navigation Co.* 363 U.S. 574, 578-79 (1960).

Respondent submits that the rule here should be that absent any demonstrated secondary intent the contract terms should be liberally construed and interpreted as applying to legal activity.

Any other rule would call from the grave the ghost of hypertechnical drafting from a day in ancient common law when contract language meant more than the presumptions of law and when desired simplicity in drafting became prey to miles of verbage.

### CONCLUSION

Respondent respectfully submits that the Board's petition for enforcement be denied.

Respectfully submitted,

BAILEY, SWINK, HAAS AND LANSING

PAUL T. BAILEY

RONALD B. LANSING

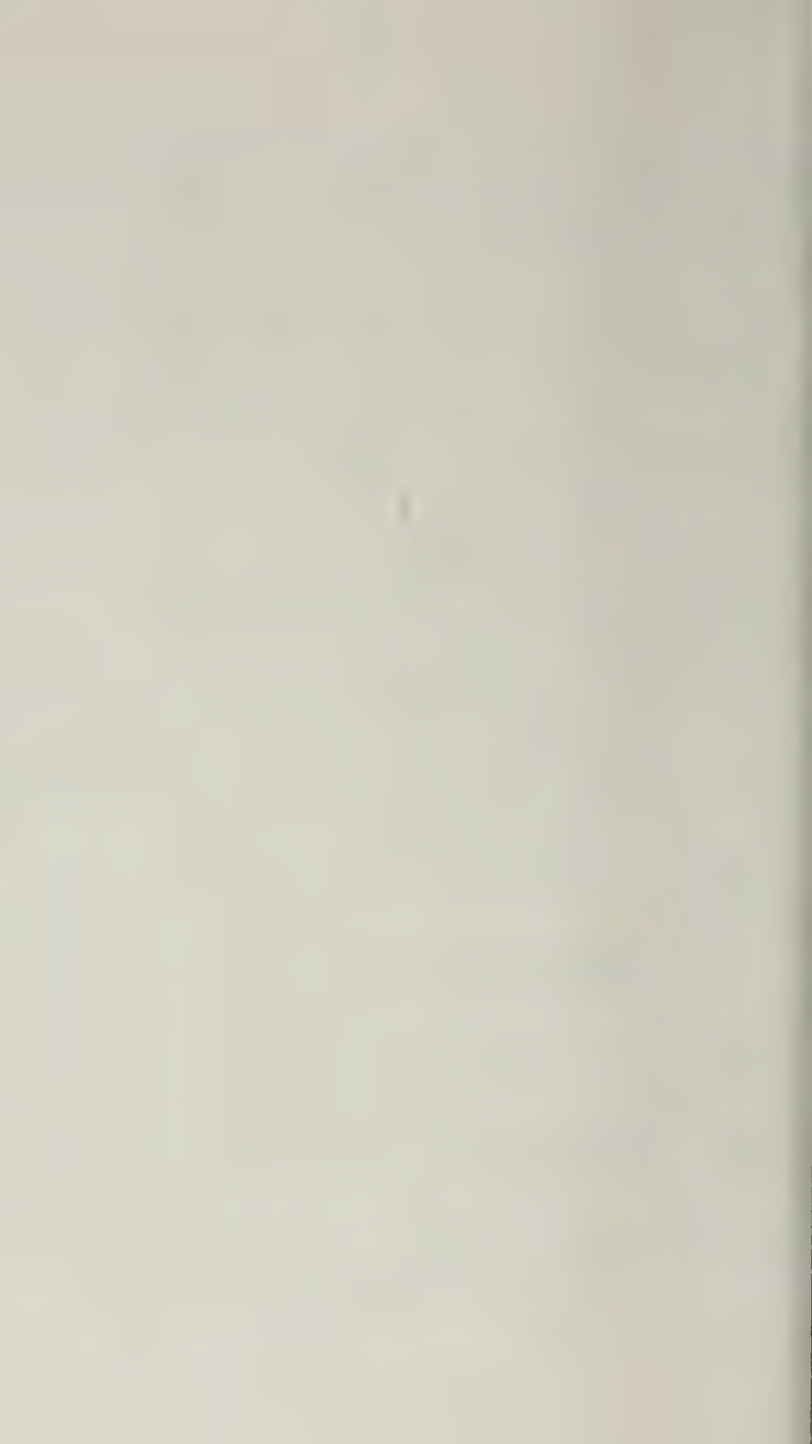
Attorneys for Respondent

### CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RONALD B. LANSING

Of Attorneys for Respondent



**In the United States Court of Appeals  
for the Ninth Circuit**

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**NATIONAL LABOR RELATIONS BOARD, PETITIONER**

*v.*

**LANE-COOS-CURRY-DOUGLAS COUNTIES BUILDING AND  
CONSTRUCTION TRADES COUNCIL, RESPONDENT**

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**On Petition for Enforcement of an Order of the  
National Labor Relations Board**

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**REPLY BRIEF FOR THE NATIONAL LABOR  
RELATIONS BOARD**

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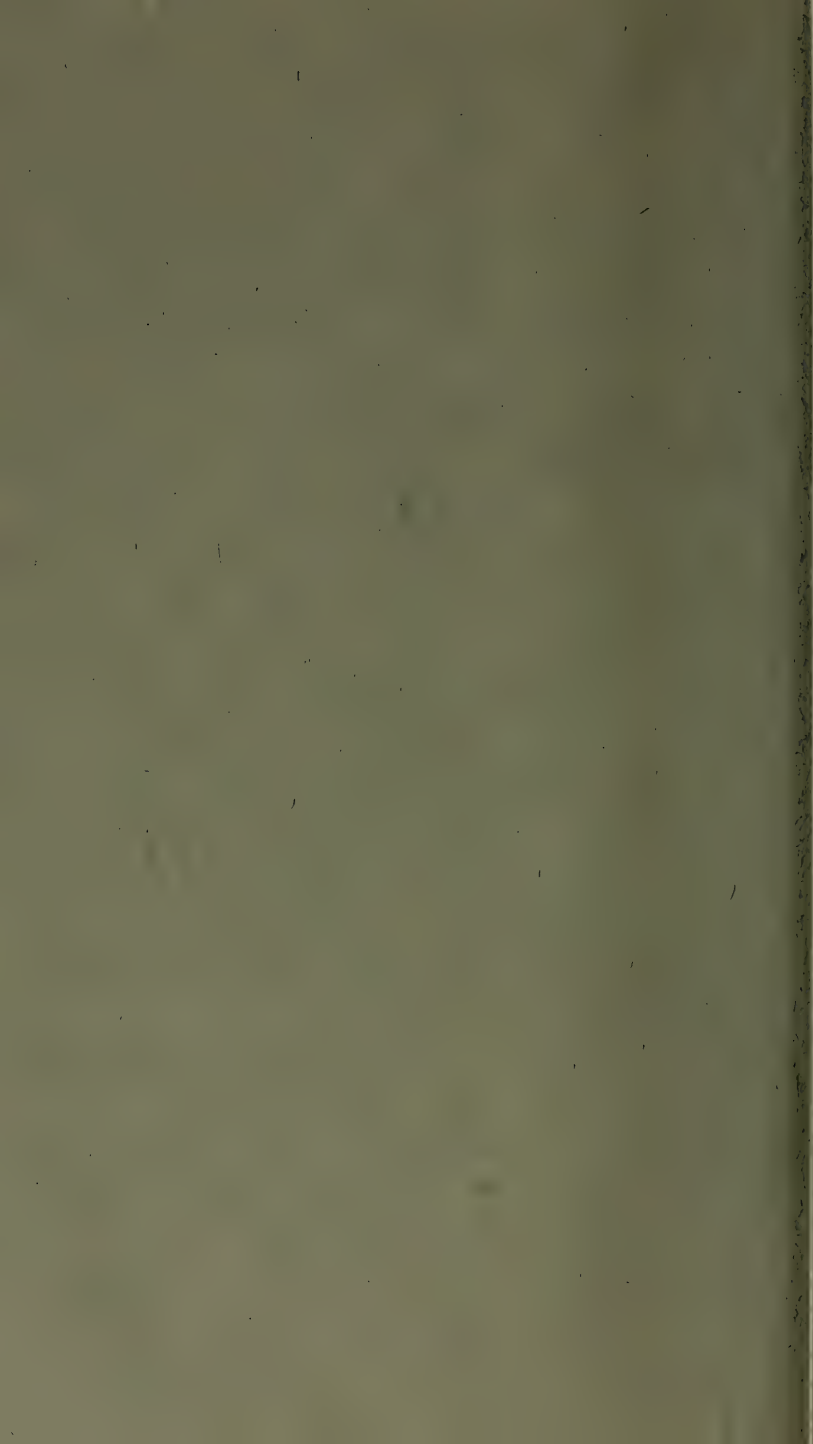
*National Labor Relations Board.*

**FILED**

**JUL 1 1966**

**WMA. B. LUCK, CLERK**

**FEB 14 1967**



**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 20,783

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In our opening brief, we showed: (1) that respondent Union picketed an employer in order to compel inclusion in a bargaining contract of a certain provision, (2) that the disputed provision would allow employees covered by the contract to refuse to cross any picket line "authorized" by the Union and, in addition, would allow the employees to refuse to handle any products declared "unfair" by the Union, and (3) that execution of a contract containing such a



provision would violate Section 8(e) of the Act. Respondent, in its brief, hardly disputes all this.

In its defense, however, respondent now claims that the construction industry proviso to Section 8 (e) is applicable here, that the disputed contract provision—admittedly unlawful in other industries—is immunized by that proviso, and that the Union was consequently entitled to picket in order to secure execution of this agreement. The industry proviso referred to states that

“nothing in this subsection (e) shall apply to an agreement between a labor organization and an employer in the construction industry relating to the contracting or subcontracting of work to be done at the site of the construction, alteration, painting, or repair of a buliding, structure, or other work”.

The Board does not dispute that this case involves “an agreement between a labor organization and an employer in the construction industry”. Nor does the Board contend that picketing to secure such an agreement would be unlawful if the proviso immunized this agreement from the reach of Section 8(e). In the Board’s view, this agreement does not qualify for exemption under the proviso because it is not an agreement “relating to the contracting or subcontracting of work to be done at the site . . .”. It is, rather, an agreement whereby on-site employers consent to engage in a future boycott of any employer disfavored by the Union, regardless of whether the latter employer is engaged in work at the job site.

The legislative history of the construction industry proviso shows that it was designed to allow industry employers and unions to continue their widespread practice of including provisions in their bargaining contracts requiring that all jobsite work be performed by union employers. Such an agreement is clearly a secondary, or hot-cargo, clause: it calls for a boycott of other employers solely because of the latter's non-union status. See authorities cited and discussion at p. 7 of our opening brief. But Congress in 1959 concluded that special legislation was warranted in deference to the industry's special problems,<sup>1</sup> and, in enacting a prohibition against hot cargo contracts, it granted the industry a limited exemption. As Senator John F. Kennedy explained, this was necessary "to avoid serious damage to the pattern of collective bargaining in [this] industry." II Legislative History of the L.M.R.D.A. of 1959 (G.P.O. 1959), p. 1432 (hereinafter cited as "Leg. Hist.").<sup>2</sup>

Accordingly, the function of the proviso was to allow the parties to continue to enter into agreements

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<sup>1</sup> For a general discussion of the distinguishing characteristics of the construction industry, see Note, 60 Yale L.R. 673 (1951).

<sup>2</sup> Independent studies have buttressed this legislative judgment, showing that no other industry relies so heavily upon subcontracting clauses as a means of stabilizing employment standards to the mutual benefit of both employers and employees. Pierson, *Building-Trades Bargaining Plan in Southern California*, 70 Monthly Labor Review 14 (U.S. Dept. of Labor, B.L.S. 1950) ; Lunden, *Subcontracting Clauses in Major Contracts*, 84 Monthly Labor Review 579 (U.S. Dept. of Labor, B.L.S. 1961).

provision would violate Section 8(e) of the Act. Respondent, in its brief, hardly disputes all this.

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to make the job all-union. But, at the same time, Congress clearly indicated that the proviso was not intended to afford construction industry unions a license to boycott suppliers, manufacturers and other employers not engaged at the job site. As the Conference Report stated:

"It should be particularly noted that the proviso relates only and exclusively to the contracting or subcontracting of work to be done at the site of the construction. The proviso does not exempt from section 8(e) agreements relating to supplies or other products or materials shipped or otherwise transported to and delivered on the site of the construction." I Leg. Hist. 943.

Senator Kennedy, in urging the Senate to adopt the Conferees' position, made the same point:

"Agreements by which a contractor in the construction industry promises not to subcontract work on a construction site to a nonunion contractor appear to be legal today. They will not be unlawful under section 8(e) . . . . [But] it should be particularly noted that the proviso relates only to the 'contracting or subcontracting of work to be done at the site of the construction.' The proviso does not cover boycotts of goods manufactured in an industrial plant for installation at the jobsite, or suppliers who do not work at the jobsite." II Leg. Hist. 1433(3)

The contract provision here involved clearly exceeds the limits of the proviso's intended scope of immunity. As already shown, the on-site employees covered by this agreement would be free to refuse to cross any picket line authorized by respondent Union or by



other named labor organizations; likewise, they would be free to refuse to handle any supplies or materials delivered to the jobsite by any employer considered "unfair" by said unions. Accordingly, the clause allows the respondent to arrange for the boycotting of any union-disfavored employer without respect to whether that employer may be engaged in work at the jobsite. Respondent clearly errs, therefore, in invoking the construction industry proviso.

Respondent's misconception of the law is illustrated by its statement (Br. 10) that "the industry proviso of Section 8(e) saves and excepts [the] on-site construction industry from the effect of Section 8(e)." In fact, according to the statutory terms, the proviso saves only certain industry agreements "relating to the contracting or subcontracting of work to be done at the site". This discrepancy is crucial: under respondent's formulation, industry unions and employers could lawfully arrange to boycott any other employer whereas Congress, by the clear language of the proviso and its accompanying legislative history (*supra*, p. 4), allowed such secondary arrangements to operate only against employers engaging in on-site work. As the court stated in *Essex County District Council of Carpenters v. N.L.R.B.*, 332 F. 2d 636, 640 (C.A. 3):

"This limited exemption was granted apparently in recognition of problems peculiar to the construction industry, particularly those resulting from sporadic work stoppages occasioned by the traditional refusal of craft unionists to work alongside non-union men on the same project.



The exemption does not extend to other agreements, such as those relating to subcontracts for supplies and materials to be transported to and delivered on the construction site."

For the same reasons, respondent errs in contending that Article I of the proposed contract effectively narrows the entire agreement so as to bring it within the scope of the proviso. In the Board's view, nothing in Article I prevents Article IX (the unlawful picket line clause) from allowing job site employees to cause a boycott of any other employer, including off-site suppliers and manufacturers.

Article I provides that

"This Agreement shall apply to and cover all building and construction work performed by the Employer . . . within the jurisdiction of any Union affiliated with the Council and the contracting or subcontracting of work *to be done at the site of the construction . . .*" (emphasis in original)

This language may effectively prevent the terms of the proposed contract, including Article IX, from applying to those employees not engaged in "construction work performed by the Employer . . . within the jurisdiction of any Union affiliated with the Council." Likewise, employees not engaged in work "to be done at the site of the construction" may not be covered by the contract terms. But the vice of Article IX, the picket line clause, is that it sanctions secondary conduct against off-site employers by those employees who *are* covered. Hence, Article IX is not an agreement relating to the contracting or subcontracting

of work to be done at the site; it is an agreement whereby employees engaged in such work are allowed to cause a boycott of any other employer. Accordingly, the clause exceeds the proper bounds of the proviso.

Nor may respondent contend that this off-site boycott aspect of its picket line clause was unintentional. Apart from the fact that Section 8(e) does not require a showing of unlawful motivation (see our opening brief, pp. 10-12), it is clear that respondent did intend Article IX to apply to picket lines at locations other than the signatory employer's jobsite. This, Article IX allows employees to refuse to cross any picket line "authorized by the [signatory] Council; or any other Building & Construction Trades Council or authorized by any Central Labor Council." (emphasis added).

The cases cited by respondent do not advance its position. *Teamsters Local 695 v. N.L.R.B.* — F. 2d —, 53 CCH Labor Cases para. 11,217, 62 LRRM 2135 (C.A. D.C.) manifestly supports the Board's position here<sup>3</sup> on the application of Section 8(e) to picket line clauses. The Court also agreed with the Board that the construction industry proviso was no defense in that case. There, however, the proviso was deemed inapplicable because the signatory union represented employees who were deemed not to be engaged in "work to be done at the site". Hence, that

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<sup>3</sup> We cited the Board's decision in that case in our opening brief at pp. 8 and 12. The court decision enforcing the Board's order in full issued on May 16, 1966, shortly after our brief was filed herein.

case did not involve the issue here raised; i.e., whether a contract covering employees who *do* work at the site may lawfully provide for the boycott of off-site employers. Nor is there anything in the Court's opinion in that case to suggest that such a contract would qualify for immunity under the proviso. On the contrary, the Court stated that

“... the purpose of the section 8(e) proviso was to alleviate the frictions that may arise when union men work continuously alongside nonunion men on the same construction site . . . Nothing in the legislative history, however, indicates that the purpose . . . was also to avoid friction resulting from work on struck premises, nor are the possibilities of such friction unique to the construction industry.” 62 LRRM 2138.

In *Essex County District Council, supra*, 332 F. 2d 636 (C.A. 3), the Court held that a clause allowing construction employees to cease work was privileged by the proviso. But there, the clause was expressly limited to refusals “to work on the job site where such non-union condition exists”. 332 F. 2d at 63. Likewise, in *Construction, Production & Maintenance Laborers Union, Local 383 v. N.L.R.B. (Colson & Stevens)*, 323 F. 2d 422 (C.A. 9), the clause was expressly limited to on-site construction work.<sup>4</sup>

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<sup>4</sup> For the full text of that clause, see the Board's decision in the *Colson & Stevens* case, 137 NLRB 1650, or the Board's brief, p. 4. The Court's opinion does not set forth the clause in full, for there was no disagreement in that case that the clause would be within the proviso's reach. The real issue in *Colson & Stevens* was whether a union could picket to obtain

*Muskegon Brick Layers Union No. 5*, 152 NLRB No. 38, also cited by respondent (Br. 7), involves a completely different issue. The clause in that case required the employer to refrain from doing business on any jobsite where another employer is employing workers at wages lower than those provided for in the union contract. The Board did not deny this hot cargo clause the protection of the industry proviso for any failure to limit its geographical scope.<sup>5</sup>

And in *Los Angeles Bldg. & Const. Trades Council (Fowler-Kenworthy Electric Co.)*, 151 NLRB No. 83, the Board held that a secondary clause in a construction industry agreement was privileged by the proviso. But there, the Board found that the language of the clause as well as other surrounding circumstances precluded viewing it as applying to off-site

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agreement on such a clause or whether hot cargo clauses privileged by the proviso could be entered into only voluntarily. The Board has subsequently adopted the views of this Court on that question. *Northeastern Indiana Bldg. & Const. Trades Council (Centlivre Village Apts.)*, 148 NLRB 93.

<sup>5</sup> In the Board's view, the *Muskegon* clause exceeded the intended area of proviso immunity because it provided for strikes in the event of an employer breach and was not limited to judicial contract-enforcement methods. In *N.L.R.B. v. Local 217, United Ass'n of Journeymen*, — F. 2d —, 62 LRRM 2257 (C.A. 1), the Court disagreed with this view and held that a clause remained entitled to the benefits of the proviso even though it sanctioned independent self help by the employees to enforce the promise to boycott. The Court rested its decision on the "narrow distinction between union-induced [i.e., unlawful] and independent self-help". — F. 2d —, 62 LRRM 2259. The *Muskegon* case itself is still pending on a petition for enforcement before the Court of Appeals for the Sixth Circuit (No. 16,886).



No. 20783

In the  
**United States Court of Appeals**  
**For the Ninth Circuit**

NATIONAL LABOR RELATIONS BOARD,  
*Petitioner,*

vs.

LANE-COOS-CURRY-DOUGLAS COUNTIES BUILDING  
& CONSTRUCTION TRADES COUNCIL,  
*Respondent.*

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**BRIEF OF INTERVENOR  
AND AMICUS CURIAE**

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On Petition for Enforcement of an Order  
of the National Labor Relations Board

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**FILED**

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**MAY 18 1966**

**WM. B. LUCK, CLERK**

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# Brief of Intervenor and Amicus Curiae

## STATEMENT

This brief is submitted pursuant to permission of the Court given on April 20, 1966. General contractor Willis Hill was represented by the intervenor, Willamette General Contractors Association, when the charge was filed. Thereafter, he delegated his bargaining rights to Associated General Contractors of America, Inc., Oregon-Columbia Chapter, *amicus curiae*.

## QUESTION PRESENTED FOR DECISION

Respondent picketed the job site of general contractor Willis Hill to enforce a demand that Hill execute its standard form of collective bargaining agreement. Article IX of the proposed agreement provided:

"It is further agreed that no employee working under this Agreement need work under any conditions which may be or tend to be detrimental to his health, safety, morals or reputation, *or cross any picket line or enter any premises at which there is a picket line authorized by the Council; or any other Building & Construction Trades Council or authorized by any Central Labor Council, or handle, transport or work upon or with any product declared unfair by any of such Councils.* The Employer, Developer and/or Owner-Builder agrees that he will not assign or require any employee covered by this Agreement *to perform any work or enter premises under any of the circumstances above described and*

will conform to all health and safety regulations of the State of Oregon.” (emphasis supplied)

The question to be decided is whether the Board correctly held that Article IX is prohibited by § 8(e) of LMRA, as amended, because it authorizes prohibited secondary activity, and that respondent’s picketing to secure such agreement was an unfair labor practice under § 8(b)(4)(i), (ii) (A) of LMRA.

### **APPLICABLE STATUTORY PROVISIONS**

**Section 8(e) of LMRA** provides:

“It shall be an unfair labor practice for any labor organization and any employer to enter into an contract or agreement, express or implied, whereby such employer ceases or refrains or agrees to cease or refrain from handling, using, selling, transporting or otherwise dealing in any of the products of another employer, or to cease doing business with another person, and any contract or agreement entered into heretofore or hereafter containing such a agreement shall be to such extent unenforceable and void: *Provided*, That nothing in this subsection shall apply to an agreement between a labor organization and an employer in the construction industry relating to the contracting or subcontracting of work to be done at the site of the construction, alteration, painting, or repair of a building, structure, or other work: \* \* \*

**Section 8(b)(4)(i), (ii)(A) of LMRA provides:**

“(b) It shall be an unfair labor practice for a labor organization or its agents —

\* \* \* \* \*

(4) (i) to engage in, or to induce or encourage any individual employed by any person engaged in commerce or in an industry affecting commerce to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services; or (ii) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where in either case an object thereof is —

(A) forcing or requiring any employer or self-employed person to join any labor or employer organization or to enter into any agreement which is prohibited by subsection (e) of this section;

\* \* \* \* \*

*Provided*, That nothing contained in this subsection shall be construed to make unlawful a refusal by any person to enter upon the premises of any employer (other than his own employer), if the employees of such employer are engaged in a strike ratified or approved by a representative of such employees whom such employer is required to recognize under this sub-chapter: \* \* \*”

## ARGUMENT

### I.

The Board's position is unequivocal. In *Cement Makers Local Union No. 97, AFL-CIO (Interstate Employ-*

*ers, Inc., et al*), (1964) 149 NLRB No. 111, 57 LRRM 146. At 1473 it held that picket line and unfair goods clause identical with Article IX are not within the construction industry proviso and are forbidden by § 8(e), and that picketing to secure them is an unfair labor practice under § 8(b)(4)(i), (ii)(A):

“We also find that paragraph H \* \* \* insofar as they provide in substance that no employee need cross a picket line which is authorized by the Building and Construction Trades Council, are violative of Section 8(e) since the clause in its broad scope can be read as applying to unlawful secondary picketing. We also find that the remaining portions of these paragraphs which provide that an employee need not handle goods which have been declared ‘unfair’ by one of three named Councils is but another sanction made available to the Respondent to enforce the unlawful clauses of its agreements.”

*Interstate Employers* was followed in *Los Angeles Building & Construction Trades Council (Portofino Marina)*, (1965) 150 NLRB No. 152, 58 LRRM 1315-1317. Those two cases announced the Board’s considered conclusion that such clauses, which include the very archetype of hot cargo agreements at which § 8(e) was directed, are secondary on their face and in their purpose and effect; and to allow them on the theory that they are within the construction industry proviso would sanction a device to extend the proviso beyond contracting or subcontracting of work to be done at the

struction site, contrary to the congressional purpose. The Board's position has been repeated in an impressive, emphatic and consistent line of decisions, all of which have necessarily been questioned by respondent in this case.

*Los Angeles Building and Construction Trades Council (Couch Electric Company, Inc. et al)*, (1965) 151 NLRB No. 46, 58 LRRM 1440

*Drivers, Salesmen (etc.) Local Union No. 695 (etc.) (Madison Employers' Council)*, (1965) 152 NLRB No. 55, 59 LRRM 1131

*Teamsters, Chauffeurs, (etc.) Local No. 386 (etc.) and California Association of Employers*, (1965) 152 NLRB No. 83, 59 LRRM 1223

*Los Angeles Building & Construction Trades Council, et al and Quality Builders, Inc.*, (1965) 153 NLRB No. 38, 59 LRRM 1364

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*Bay Counties District Council of Carpenters, AFL-CIO, et al, and Jones and Jones, Inc. et al*, (1965) 154 NLRB No. 120, 60 LRRM 1190

*Local 300, Hod Carriers' and Construction Laborers' Union, etc. and Jones & Jones, Inc.*, (1965) 154 NLRB No. 142, 60 LRRM 1194

## II.

The courts have consistently endorsed the Board's conclusion that both unfair goods and picket line clauses



which are not limited to lawful primary activity violation § 8(e).

“\* \* \* ‘Hot cargo’ agreements in any form are prohibited by section 8(e). \* \* \*” *N.L.R.B. v. International Bro. of Teamsters, etc., Local 294*, (CA 1965) 342 F2d 18 at 21

An “*unfair goods*” clause was struck down by this Court in *N.L.R.B. v. Joint Council of Teamsters No. 38*, (CA 1964) 338 F2d 23 at 31, in the following terms:

“Article 34 provides that respondent employer shall not order an employee to handle the production of, or serve, an employer who is engaged in a strike or lockout recognized by respondent unions, nor discipline or discharge an employee who refuses to do so.

Article 34 is tantamount to an agreement that the employers will not deal with the struck plant. Indeed, the ‘hot cargo’ clause at which section 8(e) was primarily aimed usually took this form. The Board properly held article 34 invalid. \* \* \*”

See also *Employing Lithographers of Greater Miami N.L.R.B.*, (CA 5 1962) 301 F2d 20 at 30:

“\* \* \* It cannot now be doubted that Congress has banned agreements whereby an employer refrains or agrees, expressly or impliedly, to refrain from handling the work of another employer, \* \* \*

It has been held that an "unfair goods" clause extending only to work performed as an "ally" of a struck employer does not violate § 8(e). *N.L.R.B. v. Amalgamated Lithographers of America (Ind.)*, (CA 9 1962) 309 F2d 31 at 38; cf *Employing Lithographers of Greater Miami v. N.L.R.B.*, supra, (CA 5 1962) 301 F2d 20 at 23-29. However, if such a clause is, as here, not so limited in its scope of operation ("any product"), it is illegal, because it authorizes illegal secondary activity.

"We have held that neither the struck work clause nor the chain shop clause is unlawful. In validating the struck work clause, however, we have construed it as applying only with regard to struck work which is not customarily handled by the primary employer. But this termination clause is not so limited. It applies with regard to 'any' work received from or destined for any employer involved in a strike or lockout of the kind referred to in section 23 of the proposed agreement, whether such work was 'customary' or 'farmed out' work.

Since it is unlawful under section 8(e) for an employer to agree that he will refuse to handle work of another employer which he customarily handles, this termination clause is unlawful. The Board did not err in so finding and concluding." *N.L.R.B. v. Amalgamated Lithographers of America (Ind.)*, supra, (CA 9 1962) 309 F2d 31 at 41-42

"We agree with the Board that to the extent clause (a) protects refusals to work beyond the scope of the ally doctrine, it authorizes a secondary boycott, and so is *pro tanto* void under § 8(e) of the Labor Act. \* \* \*" *Truck Drivers Union Local No.*

413, *etc. v. N.L.R.B.*, (CA DC 1964) 334 F2d 539 at 547, cert den (1964) 379 US 916

In *Truck Drivers Local 413*, the Court sustained the Board's holding that a *picket line* clause in unrestricted terms violated § 8(e). As in this case, the clause provided that an employee could refuse to cross "any picket line. The Court held that while a limited clause authorizing refusals to cross primary picket lines would be lawful, the clause in question authorized recognition of secondary picket lines and was *pro tanto* illegal and void.

"\* \* \* To the extent that the clause would protect such a refusal to cross [a picket line which "itself in promotion of a *secondary* strike or boycott" it would then be authorizing a secondary strike, and would *pro tanto* be void under § 8(e) of the Act \* \* \*]" *Truck Drivers Union Local No. 413, etc. v. N.L.R.B.*, *supra*, (CA DC 1964) 334 F2d 539 at 547, cert den (1964) 379 US 916\*

### III.

The construction industry proviso of § 8(e) is not applicable to either unfair goods clauses or picket line clauses whose scope of operation is unlimited. In a

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\*In *Cement Masons Local Union and Madison Employers' Council*, *supra*, the Board cited *Local No. 413* in support of its view that "a broad picket line clause is violative of Section 8(e) to the extent that it applies to secondary picket lines."

finding the Board's determination that an "unfair labor practices" clause violated § 8(e), the Second Circuit said:

"Nor is the union insulated from the effect of section 8(b)(4)(ii)(A) by the 'construction industry' proviso to section 8(e). Since the proviso is limited to 'work done at the site of the construction,' it does not sanction a 'boycott against suppliers who do not work on the job site.' \* \* \* [T]he legislative history indicates that the proviso was not intended to protect agreements relating to supplies transported to and delivered on the construction site. 1 Leg. Hist. 943 (1959). \* \* \*" *N.L.R.B. v. International Bro. of Teamsters, etc., Local 294*, supra, (CA 2 1965) 342 F2d 18 at 21-22

Nor is the picket line clause in a different position under the proviso. It is neither a clause "relating to the contracting or subcontracting of work", nor limited to work \* \* \* done at the site of the construction." It relates to crossing picket lines both at the construction site and elsewhere, and consequently is not within the proviso. *Truck Drivers Union Local No. 413, etc. v. N.L.R.B.*, supra, (CA DC 1964) 334 F2d 539 at 542-545, cert den (1964) 379 US 916.

### CONCLUSION

This is not the case of a subcontract clause which is designed to protect the jobs of members of the unit. On their face, these clauses authorize secondary activity which violates § 8(e), and it is the terms of the contract

which control its validity under the statute. *Truck Drivers Union Local No. 413, etc. v. N.L.R.B.*, supra, (CA D 1964) 334 F2d 539 at 542, cert den (1964) 379 US 91. In drafting collective bargaining agreements under the act of Congress, parties must not

“\* \* \* manufacture a device for rendering i enactments virtually ineffective. \* \* \*” Sweigert, in *Brown v. Local No. 17, Amalgamated Lithographers*, (DC ND Cal 1960) 180 F Supp 294 at 304.

Respondent picketed for a contract authorizing legal secondary activities. That picketing unquestionably violated § 8(b)(4)(i), (ii) (A). The Board's order should be enforced.

Respectfully submitted,

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### **CERTIFICATE**

I certify that, in connection with the preparation of the foregoing brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney





UNITED STATES COURT OF APPEALS

FOR THE NINTH DISTRICT

NO. 20788 ✓

FRANCES T. HONG, )  
 )  
Appellant, )  
 )  
vs. )  
 )  
UNITED STATES OF AMERICA, )  
 )  
Appellee. )  
 )

---

APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

OPENING BRIEF FOR APPELLANT

FILED

MAR 29 1966

WM. B. LUCK, CLERK

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## JURISDICTION

This action was commenced in the United States District Court of Hawaii for the refund of excise taxes illegally and erroneously collected by the Appellee from the Appellant. The claims for refund were made pursuant to 26 U.S.C., Sec. 7422(a). Jurisdictional facts were alleged in paragraph 1 of the Complaint (Record of Proceedings - Page 2, hereinafter referred to as R-2). Jurisdiction of the United States District Court was conferred by 28 U.S.C. Sec. 1340 and 1346.

The action was tried by the court without a jury. The Findings of Fact and Conclusions of Law were filed on May 5, 1965 (R- ). Judgment was entered on October 5, 1965 (R- ). A Notice of Appeal was filed on November 30, 1965 (R- ). Jurisdiction is conferred upon this Court by 28 U.S.C. Sec. 1291, 1294 and 2107.

### STATEMENT OF THE CASE

Question involved. The sole issue in this case is whether an uli-uli, a dance instrument used by ancient Hawaiians, and now almost exclusively by hula dancers, and which is not ordinarily used in the rendition of musical compositions, is also a musical instrument subject to manufacturers excise tax for sales made during the calendar years 1955 through 1960.

Manner in which raised. Appellant, during the years 1955 through 1960, manufactured and sold uli-ulis. The United States illegally and erroneously assessed and collected excise taxes on such sales on the grounds that uli-ulis were "musical instruments" for the purposes of the Sec. 4151 of the I.R.C., 1954 (R-6). Appellant filed timely claims for refund (R-6),



contending that they were not. After more than six months had elapsed from the filing of such claims, Appellant brought action to recover the taxes paid (R-1).

## SPECIFICATION OF ERRORS

### I

THE COURT ERRED IN MAKING THE FOLLOWING FINDINGS OF MATERIAL FACTS:

1. That the instrument has been used in orchestral arrangements and has been used on commercially-sold phonograph records (R- ).
2. That the uli-uli is "also regarded as a musical instrument by students and experts in the field of music" (R- ).
3. That the uli-uli is similar in construction, character and use to maracas, except that maracas are more often used by members of a band or orchestra than by dancers (R- ).
4. The uli-uli is suitable for, and is used in, performing musical compositions both written and unwritten and is suitable for use in, and is used in, instructing in music (R- ).
5. That the uli-uli is a musical instrument utilized to provide rhythm, a basic component of music. Its adornment by colorful feathers, and even its use in the overwhelming majority of acts in public performances as part of the visual aspects of the hula or dance, do not change its character as a musical instrument (R- ).



THE COURT ERRED IN MAKING THE FOLLOWING CONCLUSIONS  
OF LAW:

6. Plaintiff, hereinafter referred to as Appellant, has failed to sustain her burden of showing that the uli-uli is not a musical instrument within the meaning of Treasury Regulations (R- ).

7. The uli-uli is a musical instrument within the meaning of the statute and within the meaning of the Regulations (R- ).

8. The Commissioner of Internal Revenue did not err in taxing as musical instruments the uli-ulis manufactured and sold by Appellant (R- ).

9. Defendant, hereinafter referred to as Appellee, is entitled to judgment in its favor together with its cost of action (R- ).

## III

10. THE COURT ERRED FURTHER BY ADMITTING EVIDENCE SHOWING THAT THE ULI-ULI WAS A MUSICAL INSTRUMENT PRIOR TO 1955, DESPITE THE OBJECTION OF COUNSEL THAT THE EVIDENCE THAT WAS TO BE SUBMITTED RELATED TO MUSICAL INSTRUMENTS OF OLD HAWAII (Transcript of Proceedings - pages 81, 82, 85, 86, hereinafter referred to as T - 81, 82, 85, 86).

## IV

11. THE COURT ERRED FURTHER BY FAILING TO EMPLOY THE TESTS SET FORTH IN SECTION 48.4151-1(a) OF THE MANUFACTURERS AND RETAILERS EXCISE TAX REGULATIONS AS TO WHETHER THE ULI-ULIS WERE NOVELTIES WHICH ARE UNSUITABLE FOR USE IN PLAYING MUSICAL COMPOSITIONS OR IN TEACHING MUSIC, IN DETERMINING





## ARGUMENT OF THE CASE

### SUMMARY

The arguments may be summarized as follows:

1. An uli-uli is a polished gourd partially filled with seeds, to which feathers are attached, and is used by hula dancers in the performance of their dances.

2. There is no evidence that it has been used in the rendition of a musical composition either in a public or private performance, except in one arrangement which called for bizarre sound effects.

3. The shaking of a uli-uli during the performance of a hula is no different from the banging of bamboo poles during the performance of the hula.

4. The uli-uli differs from the maracas in a number of ways, the principal difference being that the maracas is used in the rendition of a musical composition, while the uli-uli is never (except for one atypical occasion) so used.

5. The criteria to follow in determining whether or not an article is a musical instrument have been stated in the last sentence of Treas. Regs. 1.161-1(c), as the same was explained in Rev. Rul. 62-44.

6. The District Court erred in not using these criteria.

### ARGUMENT

The uli-uli is a polished gourd which is partially filled with seeds and to which feathers are attached by means of raffia strands (T - 7, 8).



Most of them are sold in curio or gift shops and the rest in music stores (T - 10). It is used by hula dancers in the performance of their dances (T - 23). It is almost never used in the rendition of musical compositions. All of the witnesses for the Appellant testified that they had never seen an uli-uli used in the performance of a musical composition and all were unaware of the existence of any scores for the uli-uli.

Mr. William Hong, husband of the Appellant, and manufacturer of the uli-ulis, testified that he had never seen an uli-uli played and had "... only seen it in conjunction with a hula dance." (T - 13). Mr. Lloyd Krause, Bandmaster of the municipal Royal Hawaiian Band, with 26 years in the musical profession, (T - 21, 22) testified that he was not familiar with the uli-ulis as a musician, had seen them used by hula dancers but never by musicians, did not know of any musical scores in which they were used (T - 23), had never seen any one in a legitimate musical organization play them, had never conducted any arrangement in which they were used and had never heard of any musical composition or score in which they were used (T - 24).

Mr. Ray N. Tanaka, a dance orchestra leader, who had been active in music since 1937 (T - 33), and who, a licensed copyist, had transcribed about a thousand copies for various instrumental parts (T - 34), testified that he had seen uli-ulis used by dancers (T - 35, 36), but never by musicians, nor used in the rendition of a musical composition, and had never seen a score or an arrangement in which the uli-uli is used as a musical instrument (T - 36). Mr. Domenico Moro, a retired bandmaster of the Royal Hawaiian Bank after having been with the band for over 14 years (T - 49



and who had started his music career as a conductor at the age of 13 (T - 49), and was now 79 years of age (T - 50), also testified that uli-ulis are never used in the rendition of musical compositions (T - 51, 52), that he had never heard of an orchestra the musicians of which used uli-ulis and knew not of any musical compositions or scores in which the uli-uli is called for (T - 53).

The Appellee's witnesses consisted of one orchestra leader who specialized in bizarre and unorthodox "musical" instruments, an assistant anthropologist and students of music of ancient Hawaii. Mr. Martin Denny, on cross-examination, admitted that he had used an uli-uli in only one musical arrangement which he recorded (T - 68), that aside from that particular recorded arrangement, he had never used the uli-uli on any other musical compositions, recorded or unrecorded (T - 70). Mr. Denny further testified that some of his rhythmic instruments ran to the "quite bizarre" and that he had "gone to quite a number of extremes in producing sounds of a rhythmic nature", including use of an African thumb piano, the sound of crickets (T - 71), sounds of birds for which "there aren't any birds for" and that part of his performance consists of the "far-out and weird sounds" (T - 73). Although he has a number of imitators, he does not know of any other group which uses the uli-uli in the rendition of a musical composition (T - 74).

Mrs. Eleanor Williamson, Assistant in Anthropology at the Bishop Museum next testified on a study relating to the music of old Hawaii (T - 81). This was admitted in evidence despite objection by counsel for Appellant on the grounds that it related to what an uli-uli was in old Hawaii and not during the period 1955-1960. This witness also testified that the uli-uli was described as a musical instrument (T - 87) in certain books brought by her





the witness stand. The titles of these books were: Ancient Hawaiian Music, Hawaiian Life in the Pre-European Period, Unwritten Literature of Hawaii, and Arts and Crafts of Hawaii. (T - 85, 86). The first book mentioned contained scores for the uli-uli for old Hawaii, but testimony by the witness was objected to by counsel for Appellant on the grounds that they did not relate to the period from 1955 to 1960. The objection was also overruled by the Court (T - 87). It should be pointed out that this witness, according to Appellee's counsel, was brought in as a student of anthropology in charge of the project on music of old Hawaii and not as a witness on the subject of "who uses uli-ulis today, or 1955 to 1960" (T - 92).

The next witness, Mrs. Dorothy Kahananui Gillett, an instructor in music at the University of Hawaii (T - 96) testified that an uli-uli is a percussive instrument of indefinite pitch (T - 99). She also referred to a work by Sachs: Dictionary of Musical Instruments, which besides being a dictionary of musical instruments was also a "poly-glossary, a multi-purpose glossary for the entire field of musical instruments" (T - 105). However, she also testified that a pulli (a bamboo split on one end which is struck by dancers) would also be classified a musical instrument (T - 109, 110). She further testified that a dog's-tooth anker, would also be classified by Sachs as a musical instrument (T - 112, 113). She found that the anker under the category of ankers. (T - 114). She would not agree with the same classification of uli-ulis as musical instruments when the bamboo poles are banged together by dancers in the Filipino dance known as "tini-cling" (T - 114). Mrs. Gillett, being the expert that she is in ancient Hawaiian music, nevertheless was not familiar with any musical composition or score



one in Hawaii which included a score for the uili-uili (T - 100). She has heard the uili-uili used with a dance and once with a group of children who recorded a chant using the uili-uili (T - 103). Other than that, she had never heard them used (T - 106, 109).

Mrs. Edwina K. Manse, who was employed "as a hula instructor and music" with the Department of Parks and Recreation (T - 117) testified that other than the one musical composition found in Appelbee's Exhibit "A", she knew of no other written musical composition in the world which called for use of an uili-uili (T - 124). Further, she knew of no unwritten compositions in which the uili-uili is used where a hula dance is not being performed by the person using the uili-uili (T - 125).

The last witness to appear, Mrs. Doreta Richards, a graduate student in the field of ethnomusicology (T - 126) testified that besides the one instance in Appelbee's Exhibit "A" and the notations for uili-uili in the book, Primitive Hawaiian Music, previously referred to by Mrs. Williamson, she knew of no other composition that requires use of the uili-uili (T - 132). She further testified that she had never heard these scores played since she was not familiar enough with the entire literature to tell whether she did or not (T - 133).

Of all the witnesses, only one, Mr. Denny, testified that he had recorded a musical arrangement using an uili-uili (T - 68), and that aside from this one arrangement, he had never used it on any other musical composition, recorded or unrecorded, and did not know of any other group which used the uili-uili in the rendition of a musical composition (T - 74). All other witnesses denied ever hearing the uili-uili in recorded form or



ing used in any orchestral arrangement. The Court, therefore, erred in finding as material fact that "the instrument has been used in orchestral arrangements and has been used on commercially-sold phonograph records" (T - 1).

The Court also erred in finding that "the uli-uli is similar in construction, character and use to maracas, except that maracas are more often used by members of a band or orchestra than by dancers". In the first place, there is no similarity in construction, character or use of the instruments. In the second place, the maracas are used exclusively by members of a band or orchestra while the uli-uli is used exclusively by dancers. There is no question here of dual use of either instrument in both rendition of musical compositions and dancing. Mr. Krause testified that he had never seen maracas used by dancers (T - 27). Neither Mrs. Richards (T - 131). Mr. Krause has seen dancers use the uli-uli but never by a musician (T - 23). Mr. Tanaka testified to the same effect (T - 35, 36). So did Mr. More (T - 51, 52, 53). In fact, no one testified that the uli-uli was used in the rendition of any musical composition during any period after 1954, except Mr. Denny, when he had one musical arrangement recorded (T - 66). And Mrs. Gillett, when she had a group of children record a chant (query, whether this is a musical composition) (T - 108).

The Court erred further in finding that the uli-uli "is also regarded as a musical instrument by students and experts in the field of music". None of the witnesses had ever seen the uli-uli used as a musical instrument except Mr. Denny, who had employed it on one occasion.





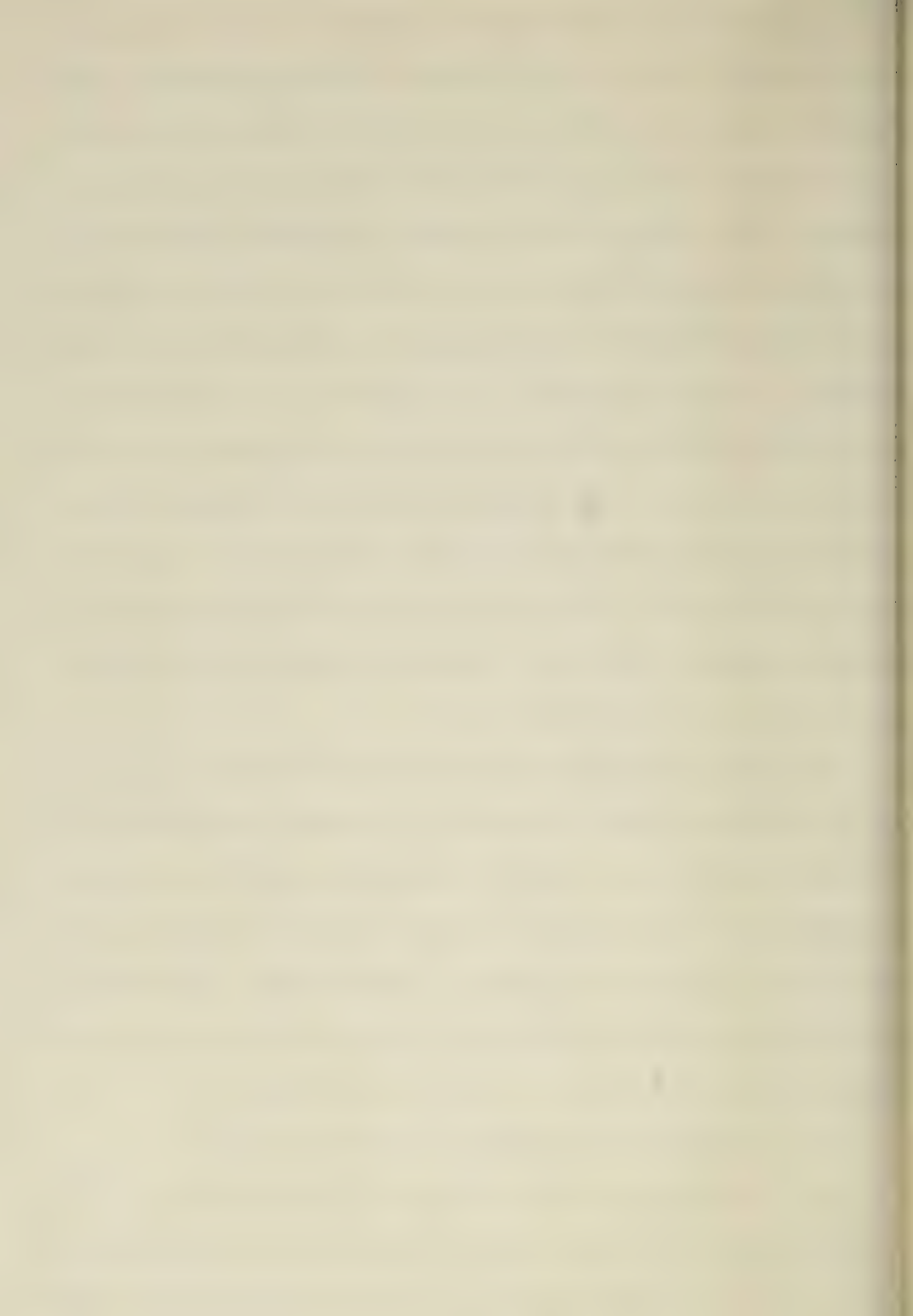
is to similarity in "construction, character and use" of the uli-uli and the maracas; The maracas, as has been pointed out, is used by members of the orchestra; never by dancers. It is vice versa with the uli-uli. There are hundreds of musical compositions which call for use of the maracas (T - 29). There is virtually none for the uli-uli. The maracas has a tapered handle and is used by a musician in an up-and-down movement. The uli-uli is used by a hula dancer in a sidewise movement or a pounding movement. By attaching feathers to an uli-uli, which is an essential part of the costume for visual aspects of the dance, it would be inconvenient for a musician to use an uli-uli in place of maracas for the up-and-down movement. In fact, the uli-uli has never been used by any musician in place of maracas, or vice versa. The uli-uli must be constructed so that it will withstand pounding by the dancer. Further, the maracas is a more articulate instrument than the uli-uli (T - 131).

The Court erred in finding that "the uli-uli is suitable for, and is used in, performing musical compositions both written and unwritten and is suitable for use in, and is used in, instructing in music". It has been shown above that musical compositions for the uli-uli, as well as the instruction thereof, is virtually nonexistent. The latter part of the statement that declares that the uli-uli is suitable for use in, and is used in, instructing in music is probably based on two lines of testimony:

Q Is this instrument suitable for instructing in music?

A It is essential if you are thinking of Hawaiian music. (T - 100).

The evidence was introduced as to how the uli-uli can be used in the instruction of music, either in theory or practice. It is impossible to conceive of how



uli, a instrument used solely by a male dancer, virtually never by a musician, for whom no scores (except perhaps one or two instances) have been written, can be deemed suitable for interacting in music.

The Court erred in finding that "the uli-uli is a musical instrument used to provide rhythm, a basic component of music. The instrument colorful feathers, and even its use in the overwhelming majority of acts in public performance as part of the visual aspects of the hula or dance, do not change its character as a musical instrument." The uli-uli may be identified as a musical instrument in the same manner as the dog's-tooth, the split bamboo sticks (pali) or bamboo poles sawed in the proper lengths for use in the Filipino tina-cling dance. To say that the uli-uli is used in the "overwhelming majority of acts in public performance as part of the visual aspects of the dance" is an understatement. It has never been seen in a public performance other than in a dance. To put it conversely, it has never been used in a public performance in the rendition of a musical composition.

The Court erred in finding the conclusions of law enumerated under the caption of errors above. In essence, these conclusions of law hold that the uli-uli is a musical instrument within the meaning of Treasury Regulations 21.4112-1(c). The last sentence of the cited Regulations states:

The term "musical instruments" does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

The pertinent regulation is discussed in Rev. Rul. 62-44. Rev.

l. 62-44 states in part:



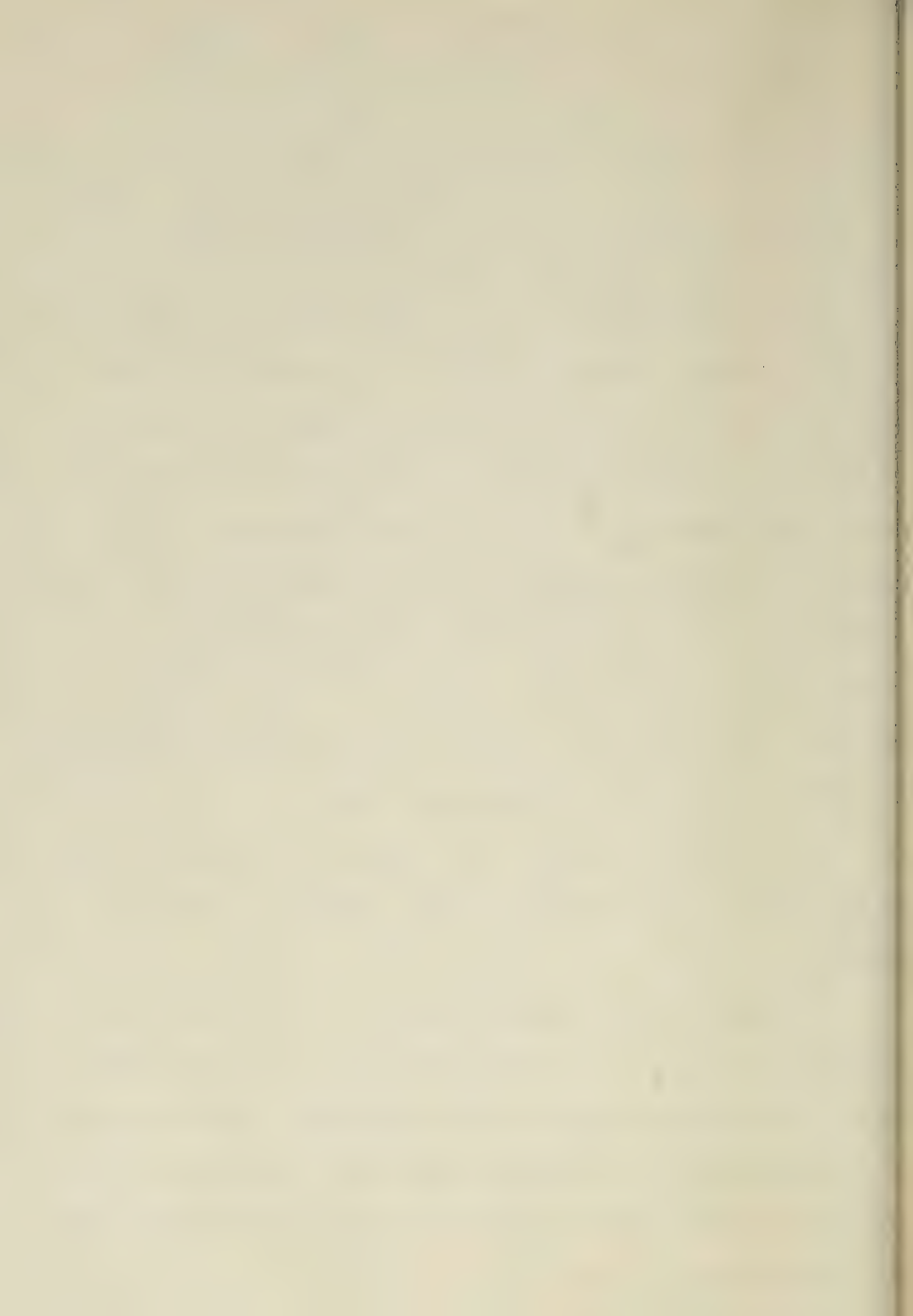
musical instrument, consideration is given to a variety of factors. Among them are the primary purposes for which the article is designed; the quality of construction of the article; whether it is a type ordinarily used in the rendition of musical instruments, either in solo presentation or in connection with other musical instruments, or whether it is adaptable for teaching proficiency in the use of musical instruments. In considering the last two factors it is not essential that the article used in musical rendition or instruction be of a professional standard of quality. The aforementioned factors are not all inclusive, and no one of them is determinative of the taxability of a particular article.

The primary purpose for which the uli-uli has been used since before 1913 is that of an article of dance. It is virtually never used, except in one unusual case, in the rendition of any musical composition, either in solo presentation or with other musical instruments. It is not adaptable for teaching proficiency in the use of musical instruments, and the Court has not so found. What the Court did find was that the uli-uli is suitable for use in, and is used in, instructing in music," a finding not supported by the evidence. The uli-uli is certainly not adaptable for teaching proficiency in the use of anything but the uli-uli.

The Court did not employ the above criteria in arriving at its decision that the uli-uli is a musical instrument. Instead it relied on the following:

1. Congress adopts legislation previously in existence and the interpretation placed by the Government previously is presumably adopted (p. 143). Appellant does not deny that; to the contrary, Appellant agrees that the Government is correct in exempting certain devices from the category of "musical instruments" when they are not such instruments, except the broadest possible category.





2. The primary purpose of Congress is to get recognition of this construction, it is not necessary to determine whether an article is really a "musical instrument". This was given prime consideration by the Court, as evidenced by the comments: "What is the only thing that is outstanding there, to me, . . . ." (T - 140).

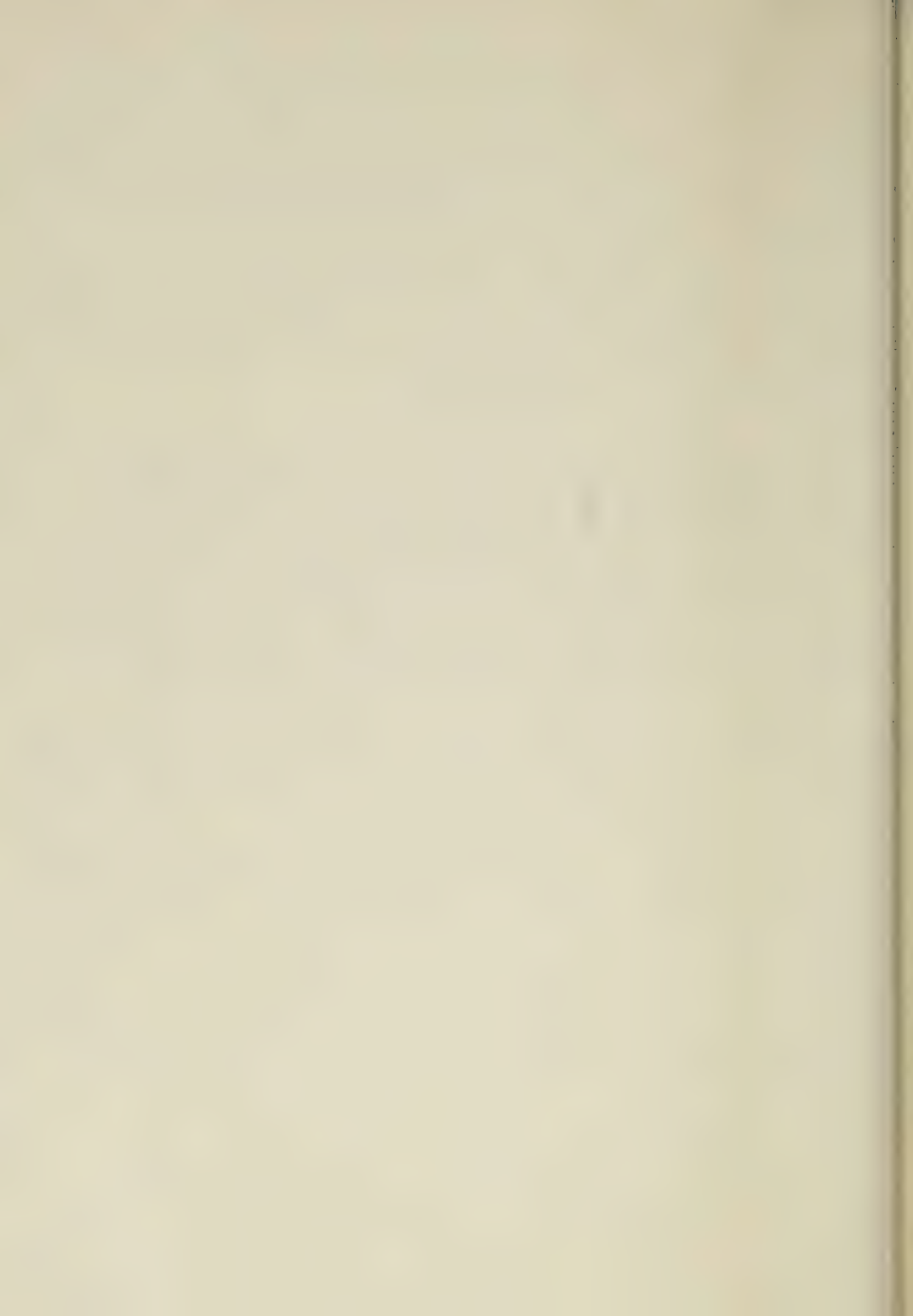
3. The historical background of the ukulele showed that the ukulele was used in ancient Hawaii to provide rhythm for the purpose of dancing. In arriving at its decision, the Court stated:

In the light of the historical origin of the instrument in this case involved and other testimony which seems to indicate and which does indicate that it was used by Hawaiians from very early times to produce rhythm for the purpose of dancing, and to produce it, sometimes, not necessarily by the dancers themselves, although I am not sure that that is an absolutely valid distinction; plus the other testimony which has been given here, plus the demonstrations made; I can't help but feel that this is a musical instrument; that it falls on the musical instrument side, although it is one of those close-to-the-borderline questions. (T - 141).

Evidence of the use of the ukulele in old Hawaii should not have been admitted because it does not relate to the period 1933 through 1960, the taxable years in question. Even if such were admissions, the evidence does not show that the ukulele was ever used, except on one or two occasions, in the rendition of a musical composition. The Court even acknowledged the fact that the ukulele has fallen into disuse as a musical instrument (T - 143). The Court stated that even though instruments be "obsolete or are not made any more "doesn't make them any less musical instruments" (T - 144).

4. The broad classification approach of a musical instrument.

That the Court relied on this test is supported by the findings that not only is the ukulele recognized as a "musical instrument" in "Recognized Historical



works on the "Musical Instruments of the World," but this is a German dictionary considered as the primary authority in the field of musical instruments; that the uli-uli is defined as a percussive instrument of indigenous pitch. Under this broad classification, not only maracas and castanets are included, but dog's-tooth anklets, split bamboo sticks and bamboo poles (T - 114).

3. The Court cited the playing of pipes by people who are dancing as an analogy. The Court stated, "Certainly, if people who played the pipes and danced while playing the pipes, we wouldn't consider that the pipes were not a musical instrument just because the people danced around while they were playing". (T - 142). We come back to the question of their use here. If a pipe, or a castanet for that matter, is ordinarily used in the rendition of a musical composition, and is also used by a dancer, the mere fact that a dancer uses them, of course, does not make the pipe or the castanet any less a musical instrument. However, where two bamboo poles are banged together in a Filipino dance both as a visual aspect of the dance and to create rhythm, would they be classified as musical instruments even though they produce sound, perhaps a "very characteristic rhythm" and such rhythm creates an "effect that is musical" and so that action "satisfies the requirements of music"? (Quotations from the opinion of the Court, T - 143). So it is with the uli-uli. The bamboo poles, the uli-uli, the split bamboo sticks (pukli), the dog's-tooth anklets--none of these are used in the rendition of a musical composition. The fact that they are used as stages does not convert them into musical instruments. The pipes and castanets are used both in the rendition of musical compositions and as dances; they are multi-purpose









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... as a ...

Respectfully Submitted,

  
\_\_\_\_\_  
Dick Yin Wong



EXHIBIT

I certify that, in connection with the preparation of this report,  
I have examined the records of the United States Court of Appeals  
for the Ninth Circuit, and that, in my opinion, the foregoing report is in  
substantial compliance with these rules.

Charles E. Jones  
Chief Clerk



No. 20788

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In the United States Court of Appeals  
for the Ninth Circuit

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FRANCES T. HONG, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

---

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT OF HAWAII

---

BRIEF FOR THE APPELLEE

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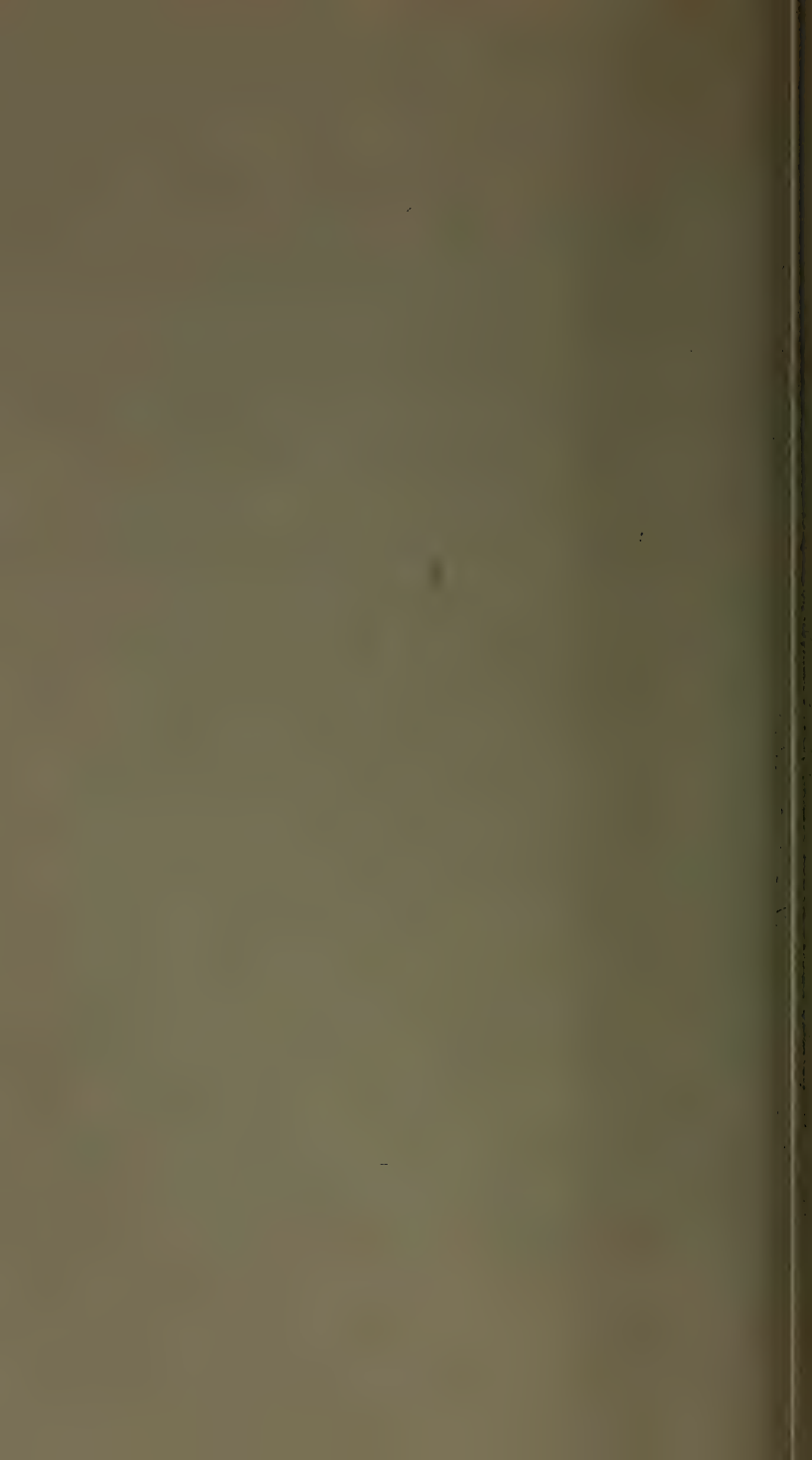
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# In the United States Court of Appeals for the Ninth Circuit

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No. 20788

FRANCES T. HONG, APPELLANT

*v.*

UNITED STATES OF AMERICA, APPELLEE

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ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT OF HAWAII

---

## BRIEF FOR THE APPELLEE

---

### OPINION BELOW

The findings of fact and conclusions of law (I-R. 3-27)<sup>1</sup> and oral opinion (II-R. 141-145) of the District Court are not officially reported.

### JURISDICTION

This appeal involves federal excise taxes for the quarters included in the years 1955 through 1960. The taxes in dispute amount to \$4,692.18, with interest of \$598.53, and were paid on December 15, 1960, and February 8, 1961. (I-R. 25.) Claims for refund for the years 1956 through 1960 were filed on November 7, 1961. (I-R. 3, 6, 13.) A claim for refund for

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<sup>1</sup> "I-R." and "II-R." references are to Volume I and Volume II, respectively, of the record on appeal.

the year 1955 and amended claims for the years 1956 and 1960 were filed on November 20, 1962. (I-R 8-9.) On August 15, 1963, within the time provided by Section 6532, Internal Revenue Code of 1954, the taxpayer brought this action in the District Court for recovery of the taxes paid. (I-R. 1-9, 25.) Jurisdiction was conferred on the District Court by 28 U.S.C. Section 1346. The judgment of the District Court was entered on October 5, 1965. (I-R. 28-29.) Within 60 days thereafter, on November 30, 1965, a notice of appeal was filed. (I-R. 30-31.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

#### QUESTION PRESENTED

Whether the District Court correctly found that *uli-ulis*, which are used to provide a rhythmic accompaniment primarily for dances and occasionally otherwise, were musical instruments within the meaning of Section 4151 of the Internal Revenue Code of 1954 and the pertinent Treasury Regulations.

#### STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

#### CHAPTER 32—MANUFACTURERS EXCISE TAXES

\* \* \* \* \*

#### *Subchapter C—Entertainment Equipment*

\* \* \* \* \*

#### PART II—MUSICAL INSTRUMENTS

#### SEC. 4151. IMPOSITION OF TAX.

There is hereby imposed upon the sale of musical instruments by the manufacturer, pro-

ducer, or importer a tax equivalent to 10 per cent of the price for which so sold.

(26 U.S.C. 1958 ed., Sec. 4151.)

Treasury Regulations on Manufacturers and Retailers Excise Tax (1954 Code):

SEC. 40.4151-1 *Imposition and rate of tax.*

\* \* \* \* \*

(c) *Definition of musical instruments.* The term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, cymbals, bongos, castanets, maracas, claves, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

(26 C.F.R., Sec. 40.4151-1.)

Section 48.4151-1(d) of Treasury Regulations on Manufacturers and Retailers Excise Tax (1954 Code), effective for the taxable years 1959-1960, is identical.

#### STATEMENT

The facts found by the District Court (I-R. 24-26), some of which were stipulated (I-R. 20-21), may be summarized as follows:

Frances T. Hong (hereafter referred to as the taxpayer), doing business as Musical Sales Company in Wailuku, Maui, manufactures and sells an instrument



known as an uli-uli. (I-R. 24-25.) It is a polished gourd partially filled with seeds, attached to a handle, and decorated with dyed feathers. It is utilized to provide rhythm, a basic component of music, to accompany a hula, chant, or song.<sup>2</sup> In the overwhelming majority of cases during the taxable period in question, insofar as the evidence of public performances indicates, the uli-uli was used by hula dancers rather than by non-dancing musicians and was used both to provide such rhythmical accompaniment and as part of the visual aspects of the dance. The instrument has been used in orchestral arrangements and on commercially-sold phonograph records. (I-R. 25-26.)

The uli-uli is recognized as a musical instrument in historical works on the musical instruments of old Hawaii. It is so recognized in a German dictionary considered to be the leading authority in the field of musical instruments. Students and experts in the field of music also regard it as a musical instrument. (I-R. 26.)

In musicology, the uli-uli is defined as a percussive instrument of indefinite pitch, a classification which includes such instruments as castanets, maracas, cymbals, triangles, the bass drum, etc. The uli-uli is also classified, according to acoustical principles, as an idiophonic instrument, a classification which also includes castanets and maracas. The uli-uli is similar in construction, character, and use to maracas, except

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<sup>2</sup> The taxpayer also makes a uli-uli of inferior quality and of smaller size which is designed for sale to tourists as souvenirs. This case is not concerned with them. (I-R. 25.)

that maracas are more often used by members of a band or orchestra than by dancers. (I-R. 26.)

The uli-uli is suitable for, and is used in, performing musical compositions both written and unwritten, and is suitable for use in, and is used in, instructing in music. (I-R. 26.)

Its adornment by colorful feathers, and even its use in the overwhelming majority of acts in public performances as part of the visual aspects of the hula or dance, do not change its character as a musical instrument. (I-R. 26.)

The taxpayer did not report and pay manufacturers excise tax on her sales of uli-ulis and she did not pass such taxes on to her customers. The Commissioner of Internal Revenue, through his delegates, determined that the higher quality uli-ulis manufactured and sold by the taxpayer were subject to excise tax. The Commissioner assessed the taxpayer for excise taxes for the taxable quarters commencing with the quarter ended March 31, 1955, though the quarter ended June 30, 1960, amounting to \$4,412.32, with interest of \$598.53. The taxpayer paid this assessment on December 15, 1960. The taxpayer filed a return for the taxable quarters ended September 30, 1960, and December 31, 1960, reported sales of uli-ulis determined by the Commissioner to be taxable, and paid \$279.86 in tax on February 8, 1961. (I-R. 25.)

The taxpayer filed timely claims for refund, or amended claims for refund, contending that the uli-ulis in question were not taxable as musical instruments. Thereafter, the taxpayer timely commenced his action for refund. (I-R. 25.)

The District Court, sitting without a jury, after hearing the evidence and viewing the demonstrations (II-R. 1-136), at the conclusion of the trial rendered an oral opinion holding that the uli-ulis in question were musical instruments (II-R. 141-145). The court noted (II-R. 141-142, 143):

In the light of the historical origin of the instrument in this case involved and other testimony which seems to indicate and which does indicate that it was used by Hawaiians from very early times to produce rhythm for the purpose of dancing, and to produce it, sometimes, not necessarily by the dancers themselves, although I am not sure that that is an absolutely valid distinction; plus the other testimony which has been given here; plus the demonstrations made; I can't help but feel that this is a musical instrument; that it falls on the musical instrument side, although it is one of those close-to-the-border-line questions.

\* \* \* \* \*

It produces, certainly, a very distinctive rhythm; and I believe the testimony, as well as what I believe to be general knowledge—which I hope I possess—in accordance with what is possessed by the average man with a musical or semi-musical ear, I believe that the effect is musical and music that is composed partly of rhythm; and to that extent, it also satisfies the requirement of music.

But this particular sound [of the uli-uli], to me at least—and I think to the average man in the street—does have the sound of a musical rhythm, and is always used in connection with a musical cadenza or musical rhythm; certain

types of timing which are distinctive to the Hawaiian hulas used in 1955 and today.

After a subsequent oral hearing on proposed findings of fact and conclusions of law, the District Court made formal findings of fact and conclusions of law. (I-R. 23-27). The court entered judgment for the Government. (I-R. 29.) The taxpayer appeals from this judgment. (I-R. 31.)

#### SUMMARY OF ARGUMENT

Section 4151 of the 1954 Code imposes a 10 percent manufacturers excise tax on musical instruments. Under the pertinent Treasury Regulations, the term "musical instrument" is defined to include all instruments which produce music except toys or novelties (i.e., articles which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music).

The instrument here involved is the Hawaiian uli-uli—a polished gourd, partially filled with seeds, attached to a handle, and adorned with feathers. The taxpayer manufactures three types of uli-ulis. The larger and better constructed ones are the ones with which this case is concerned; the third type, which is not taxed, is smaller and of a cheaper construction and is designed for sale as tourist souvenirs.

The question whether these uli-ulis are musical instruments or not is a factual question requiring the consideration and evaluation of a broad range of facts. The record clearly indicates that the uli-uli is used to provide a rhythmical accompaniment to a hula, chant, or song. Uli-ulis are similar in con-

struction and use to maracas. They are also used by hula dancers in the same way that Spanish dancers use castanets. Both maracas and castanets are expressly considered by the Treasury Regulations to be musical instruments. Moreover, uli-ulis are considered by students and experts in the field of music to be musical instruments. They are not toys or novelties which simulate the real instrument such as the souvenir instruments do; they are the genuine article. The record amply supports the District Court's findings and the court applied the proper standard. Contrary to the taxpayer's assertion, the court did not err in admitting evidence of the historical use and tradition of the instrument and can hardly be deemed to have committed reversible error by doing so.

The findings of the District Court should be affirmed; it is supported by substantial evidence and is not clearly erroneous.

#### ARGUMENT

**The District Court correctly held that uli-ulis are musical instruments within the meaning of Section 4151 of the 1954 Code and the pertinent regulations**

The question presented by this case is whether the District Court correctly held that uli-ulis—polished gourds partially filled with seeds and decorated with feathers, and used to provide a rhythmical accompaniment to a hula, chant, or song—are musical instruments subject to the federal excise tax. Chapter 32 of the Internal Revenue Code of 1954 deals with manufacturers excise taxes. Subchapter C of Chapter 32 is titled "Entertainment Equipment".



Part 2 of subchapter C, entitled "Musical Instruments", contains Section 4151, *supra*, which provides:

There is hereby imposed upon the sale of musical instruments by the manufacturer, producer, or importer a tax equivalent to 10 per cent of the price for which so sold.<sup>3</sup>

The 1954 Code provides no all inclusive definition of the term musical instrument. The Secretary of the Treasury, pursuant to his authority under Section 7805 of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sec. 7805), promulgated Section 40.4151-1, *supra*, of Treasury Regulations on Manufacturers and Retailers Excise Tax (1954 Code). That section states:

(c) Definition of musical instruments. The term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, cymbals, bongos, castanets, maracas, claves, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

This definition, which the taxpayer does not question, either in her claims for refund, at trial, or here,

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<sup>3</sup> The excise on musical instruments came into the revenue laws in 1941 when Section 545 of the Revenue Act of 1941, c. 412, 55 Stat. 687, added subsection (d) to Section 3404 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 3404). Section 404(d) of the 1939 Code and Section 4151 of the 1954 Code are substantially identical.



has the effect of law. *Commissioner v. South Texas Co.*, 333 U.S. 396, 501; *Fawcus Machine Co. v. United States*, 282 U.S. 375, 378.

The District Court, sitting without a jury, after hearing testimony and viewing the demonstrations, held that the uli-ulis in question are musical instruments subject to tax. (I-R. 26-27; II-R. 141-145.) On appeal, the taxpayer contends that the District Court erred in that: (1) Its determination that uli-ulis are musical instruments within the meaning of the statute and the Regulations is contrary to the evidence, (2) it applied an erroneous standard to the facts, and (3) it erroneously admitted evidence of the historical use and background of the uli-uli in Hawaii. (Br. 2-4.)

We submit that the District Court's findings, both evidentiary and ultimate, are supported by the record; it applied proper legal standards; and it committed no error, certainly no reversible error, in the admission of evidence.

**A. The finding of the District Court is supported by substantial evidence and is not clearly erroneous**

The question whether the instruments manufactured by the taxpayer are musical instruments within the meaning of Section 4151 is essentially one of fact which is to be resolved by the trier of fact by application of the proper standard to the relevant evidence. Given the broad character of the statutory term "musical instruments" and the numerous instruments to which it may apply, it is peculiarly the function of the trier of fact to determine whether a particular

instrument falls within or without the statutory category. This is a function to which the trier of fact is accustomed and one for which it is well suited. In this case, the trier of fact—the District Court—heard the case in the locale most closely associated with the instrument concerned, it heard the witnesses and assessed their credibility, and it witnessed the several demonstrations of the instrument. Under well-settled principles, this factual determination should not be disturbed on appeal unless found to be “clearly erroneous”. *United States v. Gypsum Co.*, 333 U.S. 364, 395. The rule applies as well to factual inferences drawn from undisputed basic facts. *Commissioner v. Duberstein*, 363 U.S. 278.

The taxpayer’s evidence consisted of the testimony of four witnesses and three exhibits.<sup>4</sup> The taxpayer’s summarization on brief (pp. 5–6) of their testimony is selective in character and the Government does not feel it necessary to repeat fully the other testimony of these witnesses, both on direct and cross-examination. The Government would, however, draw the Court’s attention to certain additional parts of the testimony of the taxpayer’s witnesses.

Mr. William Hong, the taxpayer’s husband, testified that the taxpayer made three sizes of uli-ulis in her factory and that only the larger and more expensive ones were taxed. The third type, which was

<sup>4</sup> Exhibits 1 and 2 were two uli-ulis of the kind taxed (II-R. ); by consent of counsel, a photograph was substituted for the instruments (II-R. 136). Exhibit 3 is a list of jobbers, wholesalers, and retail stores to whom the taxpayer sold uli-ulis. (II-R. 14–16.)

smaller and of a cheaper construction and which was designed for sale as "tourist souvenirs" was not taxed. (I-R. 20; II-R. 4, 11.) He stated that the gourds presently used came from Mexico and were inferior in sound to those previously obtained from Cuba. (II-R. 8.) He also stated that attempts were made to match uli-ulis in pairs according to sound. (II-R. 16.) He testified that the taxpayer sold her uli-ulis in part through her music store in conjunction with Hawaiian records. (II-R. 10.) When asked on cross-examination what the uli-uli was if it was not a musical instrument, Mr. Hong stated first that it was a "hula implement" but then added that its purpose was to produce sound. He conceded, however, that the taxpayer was not in the business of manufacturing noise-makers. (II-R. 18-19.) He did not feel qualified to testify whether the uli-uli produced a rhythmical sound, leaving that question to a musician or hula expert. (II-R. 20-21.)

Mr. Lloyd Krause, Musician-Bandmaster of the Royal Hawaiian Band, City and County of Honolulu, stated, among other things, on cross-examination as follows: He said that maracas are used in an orchestra and that maracas could be similar in size and appearance to the uli-ulis then in evidence. (II-R. 26.) He agreed that castanets were a musical instrument, that they were used by dancers as well as by members of an orchestra, that they produced the same rhythmical sound whether used by a dancer or by a percussionist in an orchestra, and that the dancers using castanets were playing from memorized

rhythms rather than from written scores. (II-R. 26-30.) He further agreed, after the uli-uli had been played for him by Mrs. Richards, who later testified for the Government, that what she produced was "a rhythmical sound". (II-R. 31.)

Mr. Roy Tanaka, a witness for the taxpayer, also conceded on cross-examination that, ignoring the adornment of feathers, the uli-uli would "look like maracas", that whether it was a musical instrument "depends how it is used", and that "it would sound like maracas". (II-R. 41, 42, 43.) He had earlier testified that he regarded the maracas as a musical instrument. (II-R. 41.) He had also testified that musical instruments did not lose their character as such merely because they had been decorated. (II-R. 41.)

Mr. Domenico Moro, the taxpayer's final witness, although not prepared to call the uli-uli a musical instrument, was willing to concede that castanets and tambourines—both of which are used by dancers—were musical instruments. Although the taxpayer's two prior witnesses had agreed, consistent with the Regulations, that maracas were musical instruments, Mr. Moro testified that he had never heard maracas played. (II-R. 56-57.)

The Government produced five witnesses and introduced two exhibits.<sup>5</sup> Mr. Martin Denny, a musician for over 25 years and a band leader since 1955 (II-R.

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<sup>5</sup> Exhibit A was a copy of sheet music for "Hula Uli Uli" or "Alekoki", a composition for the uli-uli. (II-R. 121-123.) Exhibit B was a phonograph record containing a piece utilizing uli-uli. (II-R. 134-136.)



58-59), testified that a member of his band played the uli-uli in a composition called "E li li'u e" or "Queen's Chant" (II-R. 61-62). Mr. Denny had recorded this piece and a recording of it was played for the District Court. (II-R. 62.) He testified that the uli-uli had a distinctive timbre and that it was the appropriate instrument for a Hawaiian piece such as the "Queen's Chant". (II-R. 65-66.) Mr. Denny stated that he had not used the instrument in any other orchestral arrangements. (II-R. 68.) Mr. Denny brought a maraca to court which was not introduced into evidence but which was observed by the trier of fact, and he testified that the maracas and the uli-uli were both of the "gourd family" and were "quite similar". (II-R. 63-64, 66, 77.)

Mrs. Eleanor Williamson, Assistant in Anthropology at the Bishop Museum (II-R. 79), testified regarding the research and taping of a slide and tape recording study entitled "Musical Instruments of Old Hawaii"; this study classified the uli-uli as a musical instrument (II-R. 80-82, 83-85). She also produced four books (Roberts, *Ancient Hawaiian Music* (1926); Brown, *Hawaiian Life in the Pre-European Period* (1940); Emerson, *Unwritten Literature of Hawaii* (1909); Buck, *Arts and Crafts of Hawaii* (1957)), and testified that they all described the uli-uli as a musical instrument. (II-R. 85-87.) The Roberts work also contained 23 pages of scores for the uli-uli. (II-R. 87.) Mrs. Williamson stated that she knew people owning uli-ulis who performed with them in the old ways. (II-R. 82.) She indicated that there were Hawaiian dances performed

with the uli-uli while kneeling or sitting. (II-R. 90.) She testified further that during the period 1955 through 1960 the uli-uli was for the most part used by dancers for rhythmical accompaniment and also by a small number of chanters. (II-R. 90-94, 96.)

Mrs. Dorothy Kahananui Gillett, an instructor in music at the University of Hawaii (II-R. 98), testified that she considered the uli-uli to be a musical instrument (II-R. 99, 115). She stated that it was capable of providing different rhythmical sounds or patterns. (II-R. 102.) She identified a German dictionary of musical instruments (Sachs, Real Lexicon Der Musik Instrumentes) as being recognized as a leading authority in the field.<sup>6</sup> (II-R. 103-104, 107.) A translator (Mr. Siegfried Ramler) was sworn (II-R. 104-105) and he translated the entry for uli-uli as follows (II-R. 105):

Mr. RAMLER. Uli uli, Hawaii, vessel-type rattle.

The COURT. What kind?

Mr. RAMLER. A vessel-type rattle out of a calabash filled with pebbles which rhythmically accompany songs \* \* \*.

Mrs. Gillett testified that the uli-uli was used primarily by dancers but that on one occasion she had had a group of children record a chant using uli-ulis. (II-R. 108, 109.)

Mrs. Edwina K. Mahoe, who was formerly employed as a hula and music instructor by the Department of

<sup>6</sup> Contrary to the apparent assertion of the taxpayer (Br. 7), Mrs. Gillett testified that the dog tooth anklet was not included in Mr. Sachs' dictionary of musical instruments. (II-R. 114, 116.)



Parks and Recreation and who participated in the preparation of the slide and tape study (II-R. 117), testified that she considered the uli-uli to be a musical instrument (II-R. 118-119). She stated that there were many hulas which were performed in the kneeling position and in which the primary emphasis was placed on the uli-uli rather than on the movement of the body. She stated that she taught this to children. (II-R. 119-120.) Mrs. Mahoe demonstrated a hula uli-uli and sang in Hawaiian. (II-R. 120-121.) She testified that she regarded a hula dancer as performing a musical composition, albeit an unwritten one, as well as performing a dance. (II-R. 124, 125, 126.)

Finally, Mrs. Saneta Richards, a graduate student in ethnomusicology at the University of Hawaii, stated that in her opinion the uli-uli was a musical instrument, that it was suitable for performing musical compositions, that it was capable of producing different rhythmical patterns, and that it was similar in a broad sense to a maraca. (II-R. 127-129.) Never having previously seen it, she played the score represented by Exhibit A. (II-R. 129-130.) She stated that she had seen the uli-uli used principally by dancers. (II-R. 131.)

In brief summary, there was evidence before the District Court that the uli-uli is used to provide rhythm, a basic component of music (II-R. 102), to accompany a hula (II-R. 13, 23, 35-36), a chant (II-R. 61-62, 90, 93-96, 119, 120), or a song (II-R. 120-121). During the years in question, it was predominately used by hula dancers rather than non-dancing musi-

cians. It was used to provide a rhythmical accompaniment (II-R. 18, 90-91, 121, 126) and a visual aspect (II-R. 18) to the dance. The instrument has been used, at least occasionally, in orchestral arrangements (II-R. 61-62) and has been used on commercially-sold phonograph records (II-R. 61-62; Ex. B, II-R. 135-136).

The uli-uli is recognized as a musical instrument by historical works on the musical instruments of old Hawaii and a reference work. (II-R. 85-86, 103-105.) It is regarded as a musical instrument by students and experts in the field of music. (II-R. 99, 118-119, 128.)

In musicology, the uli-uli is defined as a percussive instrument of indefinite pitch, a classification which also includes such instruments as castanets, maracas, cymbals, triangles, the bass drum, etc. (II-R. 29, 57, 99, 101-102.) The uli-uli is also classified, according to acoustical principles, as an idiophonic instrument, a classification which also includes maracas and castanets. (II-R. 101.)

The uli-uli is similar in construction, character, and use to maracas, except that maracas are more often used by members of a band or orchestra than by dancers. (II-R. 26-27, 37-38, 41, 43, 63-64, 77.) The uli-uli is suitable for, and is used in, performing musical compositions both written and unwritten (II-R. 7, 106, 119; Ex. A, II-R. 121-122), and it is suitable for use in, and is used in, instructing in music (II-R. 106, 119).

The District Court correctly held that uli-ulis are musical instruments. As the court noted (II-R. 142-143):

It certainly must produce sound. If it weren't used to produce sound, I don't think it would be used, particularly in these hulas.

It produces, certainly, a very distinctive rhythm; \* \* \* the effect is musical and music that is composed partly of rhythm \* \* \*.

\* \* \* this particular sound \* \* \* does have the sound of a musical rhythm, and is always used in connection with a musical cadenza or musical rhythm; certain types of timing which are distinctive to Hawaiian hulas used in 1955 and today.

The uli-uli is very similar in use, construction, and musical quality to maracas which are expressly treated by Section 40.4151-1(c) as musical instruments. Uli-ulis are used principally by dancers to provide rhythm for their dance in the same way castanets are used by Spanish dancers. Section 40.4151-1(c) similarly treats castanets as musical instruments. See also Rev. Rul. 54-331, 1954-2 Cum. Bull. 410 (maracas and castanets are musical instruments under the 1939 Code).

The taxpayer's argument that the uli-uli cannot be a musical instrument because it is primarily used by a dancer and therefore is incapable of being used to play a musical composition is fallacious. They are in fact used to produce music; they are used, as the District Court found (I-R. 26), to provide a rhythmical accompaniment to a hula. The uli-ulis

involved are not inferior in construction and design; they are the genuine instrument, not a toy or novelty simulating one; they are, as the District Court found (I-R. 26-27), musical instruments and that finding is plainly correct.

**B. The District Court applied the proper standard to the facts**

Under Section 40.4151-1(c) of the Regulations, the statutory term "musical instruments" is defined as including "all \* \* \* percussion \* \* \* instruments used to produce music", but not "articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music." While the Regulations expressly characterize some thirteen instruments as musical instruments, they leave to the Commissioner and to the courts the task of determining whether other instruments are included or not. Consistency and the canon of *ejusdem generis* require that instruments similar to those mentioned in the Regulations be similarly treated. This requires consideration of a number of factors, such as primary purpose for which designed, ordinary use, construction, musical tradition, capability for use in playing musical compositions and usefulness in teaching music, and the opinion of experts in the field of music. Due to the great number of instruments to which the statute may apply, these factors are not all inclusive and no one of them is determinative. The factors applicable to a given instrument and the relative weight to be accorded them by the trier of fact will vary from instrument

to instrument. The decision of a specific case, consequently, is a matter of degree and judgment.

While there has been no great body of judicial decision to consider what factors are pertinent and what relative weight is to be accorded to them,<sup>7</sup> the Commissioner has adopted this approach in several Revenue Rulings. Rev. Rul. 58-509, 1958-2 Cum. Bull. 801 (polystyrene guitars—toys); Rev. Rul. 58-540, 1958-2 Cum. Bull. 802 (plastic castanets—musical instruments); Rev. Rul. 62-44, 1962-1 Cum. Bull. 209 (testing tools—toys or novelties); Rev. Rul. 63-237, 1963-2 Cum. Bull. 509 (“junior” drums and tambourines—musical instruments).

In its oral opinion, the District Court considered the musical background of the uli-uli, its use, its musical qualities, its decoration, and the opinion of students and experts in the field of music. It also referred to what it believed would be the layman’s view. (II-R. 141-145.) In its formal findings of fact, the court also referred to the musical classification of the uli-uli, its treatment in a recognized dictionary of musical instruments and its capabilities for teaching music and playing musical compositions (I-R. 26.)

The taxpayer, however, contends that the District Court used erroneous criteria. (Br. 12-15.) In this attack on the findings and conclusions of the District Court, she places the greatest reliance on the refusal

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<sup>7</sup> Nor is there likely to be. The excise tax on musical instruments was repealed, effective June 22, 1965, by Section 204 of the Excise Tax Reduction Act of 1965, P.L. 89-44, 79 Stat. 136



of the court to consider as dispositive the fact that the uli-uli is primarily used by hula dancers to provide a rhythmical accompaniment to their dancing—a point which is reflected throughout the taxpayer's brief. Seizing upon the reference to "musical compositions" in the Regulations, the taxpayer contends that an instrument primarily used by a dancer cannot be a musical instrument since it is not used to play "musical compositions", i.e., what the taxpayer defines as something played by a non-dancing musician from a written score.

This argument ignores the essential requirement of the Regulations—that the instrument must be used to produce music, including rhythm. If articles used by dancers are musical instruments, they do not cease to be so because they are used primarily by dancers rather than seated members of a band.<sup>8</sup>

The reference to musical compositions in the Regulations on its face applies to the determination whether the article in question is a toy or novelty which simulates a musical instrument—an article having such imitations of design or construction that it cannot fulfill the function of the genuine instrument. The

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<sup>8</sup> The taxpayer would apparently distinguish castanets on the grounds that they are used by members of the orchestra as well as by dancers. (Br. 14.) Presumably she would make the same distinction for tambourines (no matter how decorated or tasselled that instrument might be when used by dancers). And the taxpayer would overlook the fact that the maracas, although played by a member of the orchestra, do for the rumba dancer precisely what the hula dancer does for herself with a uli-uli—provide accented rhythmical accompaniment.



Regulations thus would distinguish a toy piano from the genuine instrument. In the context of this case, the Regulations were applied when the Commissioner did not tax “uli-ulis of an inferior quality and smaller size which were designed for sale as ‘tourist souvenirs’ and which the Commissioner did not deem suitable for use in playing musical compositions.” (I-R. 20.) In any event, if a musical composition, written or unwritten, need be found, that requirement has been fulfilled in this case; the instrument is used to provide a rhythmical accompaniment to the dance.

The taxpayer also contends that the District Court erred in relying on the treatment of the uli-uli in historical materials on old Hawaii. (Br. 13.) Of course, the historical use of an instrument should not be the determinative factor, but this is hardly to say that it should be totally ignored. It provides information on the uses and capabilities of the instrument, its construction, and its cultural background. Cf. *Peroxide Chemical Co. v. Sheehan*, 108 F. 2d 306, 308 (C.A. 8th). Moreover, even if the court erred in referring to this material (which we hardly concede), it was surely harmless error in view of the preponderance of other evidence which pointed in the same direction.

The other points advanced by the taxpayer are quickly considered. The court, in its oral opinion, mentioned among other things the view of the man on the street. (Br. 15.) This is surely not improper. Section 4151 and the Regulations utilize ordinary

words in referring to the articles to be taxed; as the Supreme Court noted in *Addison v. Holly Hill Co.*, 322 U.S. 607, 617-618:

After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore to be understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him.

Moreover, it would seem that the laymen's view is of special interest in this case where the instrument has such a unique connection with the locale in which it is used.

It was also not improper for the District Court to refer to the authoritative dictionary on musical instruments, Sachs, *Real Lexicon Der Musik Instrumente*. (Br. 13-14; II-R. 103-105.) Courts customarily refer to dictionaries and other reference works for definitions. *Commerce-Pacific, Inc. v. United States*, 278 F. 2d 651, 654 (C.A. 9th); *Herring Magic v. United States*, 258 F. 2d 197 (C.A. 9th). Finally, the court did not rely on Congressional affirmation of outstanding administrative interpretation. This so-called criterion (App. Br. 12) was neither discussed in the court's oral opinion (II-R. 141-145) nor in its findings of fact (I-R. 26); and in any event, this matter does not seem of consequence since the taxpayer has never questioned the validity of the Regulations under which she seeks to bring herself.

**C. The District Court correctly admitted evidence of the historical background of the instrument**

During the course of the trial, the District Court admitted evidence concerning the musical tradition of the uli-uli. The Government showed a slide and tape study entitled "Musical Instruments of Old Hawaii" which was prepared by the Bishop Museum and the University of Hawaii. (II-R. 80-84, 117-118.) One of the witnesses for the Government testified concerning the contents of four books (Roberts, *Ancient Hawaiian Music* (1926); Brown, *Hawaiian Life in the Pre-European Period* (1940); Emerson, *Unwritten Literature of Hawaii* (1909); and Buck, *Arts and Crafts of Hawaii* (1957)). (II-R. 85-87.) The slide and tape study and the four books described the uli-uli as a musical instrument. In addition, the Roberts book contained 23 pages of scores for the uli-uli.

The taxpayer objected to the admission of this evidence on the ground that it related to a period prior to the taxable period in question, 1955 through 1960. The District Court overruled the objections (II-R. 81-85, 87.) The taxpayer contends that these rulings constitute error. (Br. 3, 6-7, 13.)

The court correctly admitted this evidence. It identifies the customary use of the instrument as well as the musical tradition of which it is a part. While such evidence may not be determinative of the ultimate issue of whether an instrument is a musical instrument, it is a factor which the trier of fact was

entitled to consider along with a number of other factors. The evidence is relevant to the question of customary use as well as to a general understanding of the nature and function of the instrument.<sup>9</sup> Cf. *Peroxide Chemical Co. v. Sheehan*, 180 F. 2d 306, 308 (C.A. 8th).

Moreover, since the trier of fact was a judge experienced in weighing evidence, the need for strict compliance with the exclusionary rules of evidence was considerably less than it would have been had the trier of fact been a jury. The admission of improper evidence even before a jury ordinarily will not be grounds for reversal so long as there is competent evidence to support the findings. *Pursche v. Atlas Scraper & Engineering Co.*, 300 F. 2d 467, 487-488 (C.A. 9th), certiorari denied, 371 U.S. 911; *Lessman v. Commissioner*, 327 F. 2d 990, 996-997 (C.A. 8th). In this case there was, we submit, no error in the admission of the evidence. Even if there was, the abundance of other evidence supporting the findings and conclusions of the District Court, sitting without jury, would hardly make the reception of this evidence reversible error.

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<sup>9</sup> This is particularly true here since there was evidence that during the period in issue the uli-uli was being used in the traditional fashion as well as in the modernized hula, and there was certainly no evidence showing that the uli-ulis of the taxpayer were not being used by both groups. (II-R. 82, 89-90, 119-120.)

## CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully submitted,

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APRIL, 1966.

## CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. EDWARD SHILLINGBURG,

*Attorney.*

Dated: This — day of April, 1966.

UNITED STATES COURT OF APPEALS

FOR THE NINTH DISTRICT

NO. 20788

FRANCES T. HONG,	)
	)
Appellant,	)
	)
vs.	)
	)
UNITED STATES OF AMERICA,	)
	)
Appellee.	)
	)

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APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

REPLY BRIEF FOR APPELLANT

FILED

APR 20 1986

WM. B. LUCK, CLERK

FEB 14 1967

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## SUMMARY OF THE ARGUMENT

The District Court erroneously held that uli-ulis are musical instruments within the meaning of Section 4151 of the 1954 Code, the pertinent Regulations and Revenue Rulings.

A. The finding of the District Court is not supported by the evidence and is clearly erroneous.

(1) The function of the trier of fact is to apply the proper criteria in determining whether an article is taxable as a musical instrument.

(2) Uli-ulis are not similar to castanets and maracas in that the uli-ulis are not used in the rendition of musical compositions, but are used exclusively by hula dancers.

(3) The fact that studies and students of, and experts on, ancient Hawaiian music consider the uli-uli a musical instrument is irrelevant to the determination as to whether it is such for purposes of taxation.

(4) The listing of the uli-uli as a musical instrument in a dictionary and glossary considered to be authoritative by the trier of fact is irrelevant to the determination of whether it is taxable under sec. 4151 of the I.R.C.

B. The District Court applied the wrong standard to the facts. The trier of fact should have applied the following criteria in determining whether the uli-uli is a musical instrument for the purpose of taxation:

(1) the primary purpose for which the article is designed;

(2) the quality of construction of the article;

(3) whether it is a type ordinarily used in the rendition of musical compositions;





(4) whether it is adaptable for teaching proficiency in the use of musical instruments.

C. The District Court erroneously admitted evidence of the historical background of the instrument.

D. The Appellee is bound by its own Revenue Rulings.

E. Statutes providing for taxation are to be construed strictly as against the taxing power in favor of the taxpayers.

### ARGUMENT

The District Court erroneously held that uli-ulis are musical instruments within the meaning of Section 4151 of the 1954 Code, the pertinent Regulations and Revenue Rulings.

A. The finding of the District Court is not supported by the evidence and is clearly erroneous. Appellant, in her opening brief, has pointed out that certain findings of fact were not supported by the evidence ("Arguments", p. 4). These findings were numbered 11 to 16 (I-R. 26), the first ten findings having been stipulated. Appellee's arguments may be summarized as follows: (1) It is the function of the trier of fact to make the determination as to whether an article is a musical instrument, especially when the case is heard in the locale associated with the instrument concerned; (2) uli-ulis are comparable to castanets and maracas; (3) studies of ancient Hawaiian music indicated, and students and experts considered the uli-uli to be a musical instrument; (4) and a German dictionary lists the uli-uli as a musical instrument.

(1) The function of the trier of fact, in determining whether an



article is a musical instrument, for the purposes of sec. 4151 of the I.R.C. 1954, is to apply certain standards set forth in the treasury regulations and as explained in the revenue rulings. His function is not to determine whether the article was once a musical instrument even though no longer used as such (II-R. 143, 144), or even whether it is a musical instrument today for any purpose other than that for excise taxation.

(2) Uli-ulis are similar to castanets in the sense that both are used by dancers. They differ in that castanets are ordinarily used in the rendition of musical compositions (II-R. 25, 36, 53). There are hundreds of scores or musical compositions in which castanets, claves and maracas are included (II-R. 25). On the other hand, only one of the nine witnesses testifying actually heard of the uli-uli being used in an orchestral arrangement or on a commercially-sold phonograph record (II-R. 70). All of appellant's witnesses testified that they had never seen or heard of an uli-uli performed by a musician (II-R. 13, 16, 17, 24, 36, 40, 43, 44, 52). One of appellee's witnesses was not familiar with any musical composition or score for the uli-uli (II-R. 108). Another knew of the existence of but one song scored for the uli-uli in the entire world. Another heard of one other, besides some ancient ones, but had never heard it played (II-R. 132, 133). Other differences between uli-ulis and maracas have been pointed out in Appellant's brief (p. 9, 10), the basic difference being that the maracas is not used by a dancer, while the uli-uli is used exclusively by a dancer. The Court should take judicial notice of the difference in balance when the uli-uli is attempted to be played in the same position as the maraca. The feather on the uli-uli causes a different distribution in weight and renders the



uli-uli a bulkier instrument to handle. If the maraca is so similar to the uli-uli, there would have been an interchange in the use of the instruments and one who becomes proficient in the use of one would also become proficient in the use of the other. However, it does not require any musical talent to dance the hula with the uli-uli, but a maracas player must be able to read and follow musical scores. If the maraca is considered similar to the uli-uli, a pair of wooden chopsticks or broomsticks must be deemed similar to the claves. All can be beaten rhythmically; all are wooden sticks. What, then, makes the claves a musical instrument? The simple fact that it is a standard musical instrument used in the ordinary rendition of musical compositions and for which there are many scores written (II-R. 25, 66, 53). Query, whether a swishing grass skirt which rhythmically accompanies the hula is a musical instrument under the tests used by the appellee or the toe plate attached to the shoe of a tap dancer.

(3) Studies of ancient Hawaiian music and students and experts considered the uli-uli a musical instrument. Even if all the witnesses were in accord in finding that the uli-uli is a musical instrument for historical and academic purposes, the primary issue in this case has not been answered. The witnesses were not qualified to render an opinion that the uli-uli is a musical instrument for the purposes of taxation under Sec. 4151 of the I.R.C. of 1954. Indeed, the admission of the studies referred to were objected to and should have been rejected as evidence, since they related to ancient Hawaii (II-R. 81, 87).

(4) The German dictionary referred to, which is also a





"poly-glossary,"<sup>1</sup> a multi-purpose glossary for the entire field of musical instruments" (II-R. 105), lists the uli-uli as a "vessel-type rattle out of a calabash filled with pebbles which rhythmically accompany songs". The uli-ulis manufactured and sold by the appellant are filled with seeds and are used by a hula dancer in her dance. Query, whether the uli-ulis listed in the dictionary are of the same type (there were a number of different types in existence; see (II-R. 87-90, 95) or whether the listing is accurate. Even if the dictionary is an "authoritative work", and the listing correctly refers to the type of uli-uli sold by the appellant, mere listing therein does not ipso facto render such uli-uli subject to taxation under sec. 4151, or even be accorded much weight as a factor when other criteria have been enumerated in the pertinent revenue rulings.

Appellee summarizes its own arguments, beginning with page 16 of its brief, but since the summary seems to be restatements of the findings of fact, which appellant has already discussed in her opening brief (pp. 4 - 1), appellant merely emphasizes at this point that the summary as well as the findings of fact were unsubstantiated by the evidence, to the extent indicated in appellant's opening brief. It should be pointed out, however, the chief testimony that the uli-ulis are occasionally used by chanters was by

<sup>1</sup>"Glossary" is defined as: "1. A lexicon of the obsolete, peculiar, obscure, or foreign words of a work or an author; an explanatory vocabulary dealing with a class of words, as those of a dialect or science. 2. A compilation of glosses or marginal notes." Funk & Wagnalls, New Standard Dictionary of the English Language (1931), 1043.

"Gloss" is defined as: "1. A note or comment, especially a marginal or interlinear note or a foot-note explanatory of something obscure, obsolete, or foreign in the text. 2. A superficial and plausible but misleading explanation, frequently intended to conceal a fault or defect." Ibid.



a student of anthropology who was not a witness on the use of uli-ulis during the taxable period in question (II-R. 92).

B. The District Court applied the wrong standard to the facts. Even if the findings of the District Court were substantiated by the evidence (which appellant does not concede), nevertheless the Court has failed to apply the proper standard to the facts. Appellee contends that because of the "broad character of the statutory term 'musical instruments'", it is the peculiar function of the trier of fact to determine whether an instrument is taxable. Especially so where the District Court heard the case in the locale of the instrument concerned. This may all be true in the absence of the following pertinent Revenue Rulings: Rev. Rul. 62-44, 1962-1 Cum. Bull. 209; and Rev. Rul. 63-237. These rulings set forth four factors: (1) the primary purpose for which the article is designed; (2) the quality of construction of the article; (3) whether it is a type ordinarily used in the rendition of musical compositions, either in solo presentation or in connection with other musical instruments; (4) or whether it is adaptable for teaching proficiency in the use of musical instruments. There is not involved here the question of whether the uli-uli is used primarily by dancers or primarily by musicians. There is here no dual use such as is true of the castanets or the pipes (see comment on pipes by the District Court (II-R. 142) ). Appellant agrees that if the uli-uli were a musical instrument as defined by the revenue rulings, it would not be any less so because it is also used by hula dancers.

(1) Primary purpose for which the uli-uli is designed. The incontrovertible evidence shows that the uli-uli is designed for the sole purpose



(2) Quality of construction of the article. This factor probably has reference to the quality of an article which is supposed to be a toy version of the genuine article as compared to the quality of the genuine article. See Rev. Rul. 63-237 (drums and tambourines) and 62-44 (wind instrument and percussion instrument). Appellee makes a point that the tourist version of the uli-uli has not been taxed, since it falls within the "toy or novelty" exception of the Regulations, and that the genuine article should be taxed. Appellant contends, however, that the "genuine" article is not a musical instrument to begin with.

(3) Whether the uli-uli is ordinarily used in the rendition of musical compositions. Again the evidence is uncontradicted that the uli-uli is almost never used in the rendition of musical compositions. It cannot be said that it is even occasionally, let alone ordinarily, so used. The uncontradicted evidence shows that only once was the uli-uli used in the rendition of a musical composition (II-R. 68), and it was by a musician who strived for "far-out and weird sounds" (II-R. 73). None of appellant's witnesses had ever heard of compositions or scores for the uli-uli, let alone seen a performance of one by a person who was not doing a hula (II-R. 13, 16, 17, 34, 36, 40, 43, 44). Of appellee's witnesses, Mrs. Gillett was not familiar with any composition for the uli-uli (II-R. 108). Mrs. Mahoe knew of the existence of but one song scored for the uli-uli (II-R. 124). Mrs. Richards knew of one other, but had never heard it played (II-R. 132, 133). Mrs. Williamson, who was not "offered as a witness on the subject of who uses uli-ulis today or 1955 to 1960" (II-R. 92), testified that pages 237 to 260





of a book by Helen Roberts, entitled Ancient Hawaiian Music, contained scores for uli-ulis. These scores were not, however, limited to the type of uli-uli in question, but included types which are in the Bishop Museum collection as well as some which are not in the collection (II-R. 87 - 90, 95). There is no testimony by Mrs. Williamson that she has heard any of these scores performed and Mrs. Richards testified that she had never heard any of them performed (II-R. 132, 133).

(4) Whether it is adaptable for teaching proficiency in the use of musical instruments. There is absolutely no evidence that the uli-uli is adaptable for teaching proficiency in the use of musical instruments. The "evidence" which comes closest (but not very close) is embodied in a conclusion drawn out of appellee's witness by appellee's counsel:

Q Is this instrument suitable for instructing in music?

A It is essential if you are thinking of Hawaiian music. (II-R. 106)

No evidence was adduced as to how the uli-uli can be used in the instruction of music, either in theory or practice. Cf. Rev. Rul. 62-44, wherein the test used is whether the article "is adaptable for teaching proficiency in the use of musical instruments", 1962-1 Cum. Bull. 209, and not the abstract test of "instructing in music". It also appears that the term "musical instruments" has reference to "standard instruments"; see, e.g., Rev. Rul. 62-44: The last sentence in the paragraph following the description of "(2) percussion instrument" states: "Few musical compositions arranged for standard instruments can be played on these articles." (Underline added.)

The very nature of the findings of fact, both oral and formal, indicate that the District Court had not applied the factors set forth in the revenue



rulings. A further indication can be found in the apparent reluctance of the District Court to overrule appellee's counsel's objection to the following question asked by appellant's counsel:

Q With reference to the time that you have been acquainted with music, have uli-ulis been ordinarily used in the renditions of musical compositions? (II-R. 51).

MR. FINK: Objection, your Honor. I objected to this question when put to another witness. That is not before us here. It has no relevance whether they are ordinarily used in playing musical compositions.

THE COURT: Well, it may be a leading-up question to some of the others. They have gone just about as far on the other question, Mr. Fink. You can argue that.

After the question was read back, the following transpired:

THE COURT: Just a minute. Could you say "ever" rather than "ordinarily", or to his knowledge?

MR. CHUNG: Well, your Honor, in argument we do intend to argue that one of the tests is "ordinarily". I will ask the next question.

THE COURT: All right. I will allow it subject to--well, you can argue that later, Mr. Fink. (II-R. 51, 52).

C. The District Court erroneously admitted evidence of the historical background of the instrument. This evidence was incorporated in finding of fact numbered 12 (I-R. 26). Historical background may be proper to ascertain whether an article is a musical instrument during the time when it was in use, and may be a factor to be considered in classifying the article for broad academic purposes. It certainly has no place where the issue narrows down to whether it is a musical instrument for the specific purpose of taxation, as the law and regulations are interpreted by the revenue ruling



D. The Appellee is bound by its own Revenue Rulings. The appellee should be bound by its own interpretation of the law and regulations. Treasury Regulations sec. 601.201(a)(5) states as follows:

A "Revenue Ruling" is an official interpretation by the Service which has been published in the Internal Revenue Bulletin. Revenue Rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and others concerned.

In the "Introduction" to each volume of the Internal Revenue Bulletin appears the following statement:

Revenue Rulings and Revenue Procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose. (See, e.g., 1962-1 C.B. (1).)

The revenue rulings cited hereinabove should be considered as having substantial force and effect since they are essential to the proper construction of Regulations Sec. 40.4151-1.

E. The general rule is that the statutes providing for taxation are to be construed strictly as against the taxing power in favor of the taxpayers. Gould v. Gould, 245 U. S. 151, 38 S.Ct 53 (1917); followed in Tandy Leather Company v. U. S., 347 F.2d 693 (5th Cir., 1965 reversing DC), 16 AFTR 2d 6223 (retailers excise tax not imposed on sale of leathercraft kits). The Tandy Leather case, at 695, cited 51 American Jurisprudence, "Taxation", Sec. 316, "Strict or Liberal Construction", as follows:

\*\*\* [The] correct rule appears to be that where the intent or meaning of tax statutes, or statutes levying taxes, is doubtful, they are, unless a contrary legislative





intention appears, to be construed most strongly against  
the government and in favor of the taxpayer or citizen. 1  
[Citing a number of cases.] Any doubts as to their meaning  
are to be resolved against the taxing authority and in favor  
of the taxpayer.

Respectfully submitted,

*Dick Yin Wong*

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Dick Yin Wong



A wind instrument consists of a plastic tube approximately 11 inches long. It has a removable plastic mouthpiece and has seven finger holes on one side and a thumb rest and finger hole on the other. Two musical scales may be played on it.

A percussion instrument consists of twelve metal tubes of the same diameter mounted in a frame. The tubes differ in length, graduating from approximately five inches to nine inches. The notes which they produce range from "middle C" to "G" above "high C." It is played by striking the tubes with a wooden mallet.

*Held*, because of the limitations on the use of the articles, they are not generally suitable for the rendition of musical compositions or adaptable for teaching music and are not subject to the manufacturers excise tax on musical instruments imposed by section 4151 of the Internal Revenue Code of 1954.

Advice has been requested concerning the applicability of the manufacturers excise tax on musical instruments, imposed by section 4151 of the Internal Revenue Code of 1954, to sales by the manufacturer of the articles described below.

(1) *A wind instrument.*—This article consists of a plastic tube approximately 11 inches long and a removable plastic mouthpiece. It has seven finger holes on one side of the tube and a thumb rest and a finger hole on the other side. Two complete musical scales may be played on the article by manipulating the fingers over these holes and blowing into the mouthpiece.

(2) *A percussion instrument.*—This article consists of 12 metal tubes of the same diameter mounted in a frame. The metal tubes are graduated in length from approximately five inches for the smallest to nine inches for the longest. The notes which they produce range from "middle C" to "G" above "high C." The article is played by striking the metal tubes with a wooden mallet.

The instruments are designed, advertised, and sold for use as tools to test musical potential and to develop and encourage interest in music for the purpose of preparing a student for the playing of a musical instrument. The selections that may be played on both the wind instrument and the percussion instrument by reason of the limitations in design and other characteristics of the devices are limited. Few musical compositions arranged for standard instruments can be played on these articles.

Section 4151 of the Code imposes a tax upon the sale of musical instruments by the manufacturer, producer, or importer thereof.

Under the provisions of section 48.4151-1(d) of the Manufacturers and Retailers Excise Tax Regulations, the term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

In determining whether a particular article is a musical instrument, consideration is given to a variety of factors. Among them are the primary purposes for which the article is designed; the quality of construction of the article; whether it is a type ordinarily used in the rendition of musical compositions, either in solo presentation or in connection with other musical instruments, or whether it is adaptable for teaching proficiency in the use of musical instruments. In considering the last two factors it is not essential that the article used in musical rendition or instruction be of a professional standard or quality. The aforementioned factors are not all inclusive, and no one of them is determinative of the taxability of a particular article.

The instruments here under consideration are widely used to test the musical potential of children and to encourage the instruction of music; they are of a design and quality comparable to toys or novelties which simulate musical instruments, and their relationship to the actual teaching of music is limited to determining whether children have sufficient natural musical ability to warrant the additional instruction required to teach them proficiency in the use of a standard musical instrument. Thus, these instruments are not "musical instruments" as defined in section 48.4151-1(d) of the regulations.



Drums and tambourines which are suitable for use in playing musical compositions or for use in teaching music are musical instruments within the meaning of section 4151 of the Internal Revenue Code of 1954, even though they are referred to as "toys" by the manufacturer.

Advice has been requested concerning the applicability of the manufacturers excise tax on musical instruments to sales by the manufacturer of the articles described below.

A company manufactures and sells certain "junior" drums and tambourines. The drums are constructed with shells of one-eighth-inch thick, factory-second, unseasoned wood. Some of the shells have a plastic covering; others are merely stained and given one coat of lacquer. The drum heads are made of split water-buffalo hide. The metal parts of these drums are plated with an inexpensive nickel plating. They are equipped with a single tensioning device and counter hoops. The tambourines are of two-piece plywood rim construction with heads of split water-buffalo hide and jingles of thin steel.

The company refers to these drums and tambourines as "toys" in its advertising circulars and price lists. Moreover, they are displayed as toys at toy fairs. However, the company sells these articles through the same merchandising channels as it does its higher quality musical instruments. The company contends that these drums and tambourines are designed for use as toys.

Section 4151 of the Internal Revenue Code of 1954 imposes a tax upon the sale of musical instruments by the manufacturer, producer, or importer thereof.

Section 48.4151-1(d) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "musical instruments" includes all wind, reed, string, percussion or electronic instruments used to produce music, including but not limited to all types of pianos and organs, trombones, saxophones, violins, drums, xylophones, chimes, cymbals, bongos, castanets, maracas, claves, etc. The term does not include articles in the nature of toys or novelties which simulate musical instruments and which are unsuitable for use in playing musical compositions or in teaching music.

In determining whether a particular article is a musical instrument, consideration is given to a variety of factors. Among them are the primary purpose for which the article is designed; the quality of construction of the article; whether it is a type ordinarily used in the rendition of musical compositions, either in solo presentation or in connection with other musical instruments; or whether it is adaptable for teaching proficiency in the use of musical instruments. In considering the last two factors, it is not essential that the article used in musical rendition or instruction be of a professional standard or quality. The aforementioned factors are not all inclusive, and no one of them is determinative of the taxability of a particular article. See Revenue Ruling 62-44, C.B. 1962-1,209.

The drums and tambourines described above are constructed of material of a better and more durable quality than is generally found in toys. The heads of the drums and tambourines are made of a material which produces the desired sound for musical compositions. The jingles on the tambourines conform favorably to the tone quality generally found in higher quality tambourines. Therefore, these drums and tambourines are not considered to be in the nature of "toys or novelties which simulate musical instruments" within the scope of the regulations, but articles which are suitable for use in playing musical compositions or for use in teaching music.

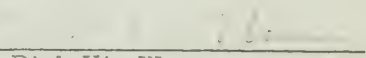
In view of the foregoing, it is held that these drums and tambourines are musical instruments within the meaning of section 4151 of the Code. Accordingly, sales by the manufacturer thereof are subject to the manufacturers excise tax on musical instruments, imposed by that section.





CERTIFICATE

I certify that, in connection with the preparation of this brief, have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

  
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Dick Yin Wong



# UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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LUMBERMENS MUTUAL CASUALTY  
COMPANY, an Illinois Corporation, and  
WALDORF-HOERNER PAPER PRODUCTS  
COMPANY, a Montana Corporation,  
Plaintiffs and Appellants

— vs. —

BABCOCK & WILCOX COMPANY, a New  
Jersey Corporation, and CLARAGE FAN  
COMPANY, a Michigan Corporation,  
Defendants and Appellees

---

Appeal from the United States District Court  
for the District of Montana, Missoula Division

## REPLY BRIEF OF APPELLANTS

Lumbermens Mutual Casualty Company  
Waldorf-Hoerner Paper Products Company

---

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Clarage Fan Company



The net substance of respondents' brief convinces the reader that their whole position finally depends upon avoiding the significance of Adamek's testimony that the fan failure issue was not discussed and settled, from which they reason that since the fan failure issue was not *excluded* from the correspondence in explicit words, it therefore must have been *included*.

Running through all the pages of argument to this general effect are charges of what amount almost to professional impropriety and over-reaching on our part, so as to minimize the forces supporting our contentions. Thus, there are references to our tricks of advocacy (p. 10), our effort to emasculate Rule 52(a) (p. 10), secret reservations suggested to Sandberg (p. 24), Adamek being misled by a trap question (p. 26), deliberate distortion of meaning (p. 28), careful ignoring of evidence (p. 29), strange coyness about the insurance payments (p. 37), etc.

It would be most unfortunate if such characterizations were somehow to divert significant testimony from full and fair evaluation, and while in this court it doubtless would not happen, yet we feel some reply is due.

First, let us regain perspective. The question is whether a clearly intended settlement of



certain specific issues also was an unarticulated settlement of another and different issue.

For the purpose of illustration, let us for the moment *assume* that Adamek's testimony as quoted on p. 18 of our original brief is true, and that Adamek and Sandberg did *not* undertake to discuss and negotiate out the fan failure liabilities. If we assume this as truth, and test the ensuing correspondence and conduct of the parties accordingly, does it not appear that they are exactly what one would expect? If the subject was not discussed and settled, isn't it perfectly normal that neither one would explicitly *exclude* it from his closing record? Who routinely negatives things that are not involved? And would not each leave to the other his own intra-company breakdown of the closing on whatever basis he might wish, and not challenge it further? And is it not also consistent with this that neither Clarage, nor Babcock & Wilcox counsel, nor anyone else, were informed that warranty and product failure claims by Waldorf had been affirmatively paid and discharged on an undefined basis of which no record is to be kept? We think all these are very persuasive that in *fact* he testified to the truth.

Now, let us examine more closely the charge that Adamek was misled by a trap question. Could he somehow have been mistaken in what he said?

His deposition was taken in his office in Minneapolis by stipulation, with trial counsel for both parties participating. In advance, he had discussed the case with counsel, and had read Sandberg's deposition (p. 7, l. 15-21). Adamek is a Sales Engineer for Babcock & Wilcox, with twenty-four years of service to that Company at the time of the deposition. How does a lawyer go about trying to mislead a college-educated, experienced, fully familiarized witness in his own field, accompanied by his own counsel? We may think we are good lawyers, and we try to be, but we aren't that good!

Furthermore, we did not try to mislead him, and the record shows this. Thus:

“Q. From all of these matters you know in general that the purpose of our taking this deposition now is to establish your knowledge as to the truth and correct interpretation of the letters passing between your company and Waldorf dated September 7, 1962 and September 10, 1962 and another one September 11, 1962?

A. Yes.”

(P. 7, l. 22—p. 8, l. 3, Adamek depo.)

Then followed many pages of interrogation on various phases of the case, after which came the “trap” question—and what is in the nature of a trap we do not perceive.

“Q. Let me ask you whether in the course of this meeting there in August of 1962 you and the service department and Mr. Sandberg undertook to discuss and negotiate out any liability of either your company or the Clarage Fan Company on the warranty for the induced draft fan or responsibility for the failure of the fan?

A. Not that I recall.

Q. And this would not have been a province of the service department, I take it?

A. I don't believe it would be.

Q. And really it would not be a part of the function of your department, the sales department?

A. That's true.”

(P. 35, 15-17, Adamek depo.)

His answers seemed clear and to the point, so the subject was not further pursued.

Then came cross examination by his company's own counsel, with whom he had conferred that morning.

“Q. Did you ever see those figures until this letter arrived?

A. I never saw them until this letter.

Q. Then did you notice the language in the letter, 'You have refused to consider

any allowance for Waldorf labor, supervision, travel expense of the writer and Waldorf St. Paul engineering staff, Westinghouse and Clarage Fan Company serviceman's labor and material to restore the two No. 2 ID fan and drive, after two complete failures (the first one occurred within the one year warranty period)'. Were you aware of that being in his letter?

A. Yes.

Q. Now, does that recall anything to you with respect to the conversation between Mourer and Sandberg as to whether or not they had discussed the responsibility for the fan failures at your meeting?

A. I can't recall any specific statements or anything, but the responsibility for the fan failure, since it happened within the one year period and we have a one year warranty on material, is definitely Babcock & Wilcox's responsibility to replace it.

Q. Yes, *but was there a discussion about this?*

A. *I can't recall."*

(P. 44, 1. 10—P. 45, 1. 7, Adamek depo.)

Here was the same answer, "I can't recall," to the question of whether responsibility for the fan failures was *discussed*, much less whether the responsibility was *compromised and settled*. On p.

42, he had already testified that he knew of the failures, but “no money or charges or anything involved.” Parenthetically, let us ask how one decides to settle major claims, when he does not have knowledge of “money or charges or anything involved.”

Certainly he was not being misled or trapped by his own counsel, and yet his answers were to the same effect as to us. Thus it is that we feel they ring absolutely true, and are the key to this case. When Adamek read over his words, signed the deposition, swore to its truth, and did not come to the trial to testify to any different view, we contend that the position he stated shows forth clear and true, with nothing either distorted or ignored. Therefore, when both principals swear they did not discuss and settle the fan failure liabilities, there is nothing to support the Court’s finding that the parties used language “appropriate to effectuate” the intention to settle them notwithstanding. (Finding VIII).

There are other replies to other points made by respondents, but in the interest of brevity we will respond to them at the time of oral argument.

Respectfully submitted,

J. C. Garlington

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### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney





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# UNITED STATES COURT OF APPEALS

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LUMBERMENS MUTUAL CASUALTY  
COMPANY, an Illinois Corporation, and  
WALDORF-HOERNER PAPER PRODUCTS  
COMPANY, a Montana Corporation,  
Plaintiffs and Appellants

— vs. —

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Jersey Corporation, and CLARAGE FAN  
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Defendants and Appellees

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Appeal from the United States District Court  
for the District of Montana, Missoula, Montana

## BRIEF OF APPELLEES

Babcock & Wilcox Company  
Clarage Fan Company

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**FILED**

Filed: ..... MAY 2 1966 ..... 1966

WM. B. LUCK, CLERK, Clerk

B 141367



# UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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LUMBERMENS MUTUAL CASUALTY  
COMPANY, an Illinois Corporation, and  
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## STATEMENT OF THE CASE

Appellants' Statement of the Case is argumentative and fragmentary and hardly suffices to explain the issue here presented.

In December of 1959, Babcock & Wilcox (hereinafter called B&W) contracted with Waldorf-Hoerner Paper Products Company (hereinafter called Waldorf) to install at its Missoula plant a "power boiler" referred to by the parties as "PFI-2799" and also to duplicate an existing "recovery boiler" which the parties often referred to as "No. 2 Recovery" or the contract number "PR-58." The recovery boiler involves a high capacity induced draft (See: Sandberg Dep. pp. 20-21; Mourer, Tr. Vol. II, pp. 4-5), and the defendant and appellee, Clarage, was the manufacturer of the large fan sold to B&W and installed between the boiler and the stack to produce this draft.

The units were installed and commenced operation about October 1, 1960. Thereafter the power boiler had a number of tube failures which resulted in spirited controversy at least so far as Mr. Sandberg, Waldorf's president, was concerned. The power boiler is not involved in the suit but the controversy is highly material as to the type of thing the parties later "settled."

On March 30, 1961, and some six months

after operation commenced, the large induced draft fan did fail, disabling the operation, however there is absolutely nothing in the record that it "spun apart" as appellants' counsel states in their "chronological history" (Brief, p. 6). The I. D. fan (and there is only one) again broke down on October 28th, 1961. Subsequently, Lumbermens Mutual Casualty Company came into the picture and, as the insurance carrier for Waldorf, paid it money for the fan outages. When this occurred, or what type of insurance is involved, we do not know. While appellants now contend that the "settlement" of September 11, 1962 questioned by this appeal destroyed "Lumbermen's right without its representation" there is no suggestion in the pleadings or in the proof that the representatives of B&W had any knowledge or any notice of Lumbermen's rights or claimed subrogation.

Although the units had been in operation since the fall of 1960, Waldorf and Sandberg were at least dragging their feet on making payment under the contracts to furnish and install the units. Prior to March 27, 1962 there was nearly \$85,000.00 still unpaid (Adamek's letter, Ex. "B", Sandberg Dep., p. 44). B&W had been trying to collect for about a year and a half and had a non-productive meeting to that end in

March of 1962 (Mourer Tr., Vol. II, pp. 8-10). In March Adamek and Mourer "had a nice visit" and went through the plant but accomplished no more because Sandberg didn't have his figures together that he wanted to talk about (Adamek Dep., p. 10, lines 11-25). In a nutshell, what it came down to was that Mr. Sandberg just wasn't going to pay B&W its retention until he was paid for the things he had coming (Countryman, Tr., Vol. II, p. 68 lines 17-23; Mourer, id. p. 11, lines 9-22). In his letter of March 27, 1962 (Ex. "B", Sandberg Dep., p. 44) Adamek, who was sales manager for B&W, sought a meeting the first part of April. There followed a series of correspondence between Adamek and Sandberg which finally terminated in a firm commitment for a meeting on August 28, 1962. That correspondence will be referred to later and is found in Sandberg's Deposition as Exhibits B through I, inclusive, from pages 44-51.

The parties met in Missoula—Waldorf was represented by Sandberg, its President, and Countryman, who was then its Production Manager; B&W, by Adamek, its Sales Manager; and Mourer, its Denver District Service Engineer. Sandberg still didn't have his figures but it was agreed that as of that time Waldorf still owed \$25,576.00. There was no real attempt to nego-

tiate on the 28th and on the 29th the parties had accomplished nothing after several hours of attempting to get together item by item. Adamek then took the bull by the horns and, after a whispered consultation with Mourer, turned to Sandberg and offered to settle on a lump-sum basis by just splitting the \$25,576.00. This was acceptable to Sandberg and the meeting broke up in all good fellowship. Thereafter, each party made its own breakdown of specifics for accounting purposes. On September 7, 1962, Sandberg wrote the critical and controlling letter to Adamek (Ex. 1, App. Appellant's Brief, pp. 29-30), making specific reference to the No. 2 I.D. fan failures and expense in connection therewith.

On the 10th, Adamek wrote pointing out that "Contract SC-1387" was not included in the "settlement made at your plant"; went on to explain that allowance had been made on the I.D. fan and asked Sandberg to confirm the elimination of Contract SC-1387 before the check was passed on to B&W's New York Treasury Department (Exhibit 2, App. Appellants' Brief, pp. 31-33). On the 11th Sandberg wrote that the reference to SC-1387 was in error and a check for it would be issued shortly (Ex. 3, App. Appellants' Brief, p. 33).

All was serene until Lumbermen's came

openly into the picture with the filing of the complaint here on March 29, 1963. (Tr. Vol. I, pp. 6-13). In due course each defendant answered separately denying knowledge or information sufficient to form a belief as to any payment made by Lumbermen's and affirmatively pleading that any claim for the fan failures was settled, satisfied and discharged by a compromise settlement entered into between Waldorf and B&W on or about September 11, 1962. (B&W Answer, Tr. Vol. 1, p. 17 lines 1-20); Clarage Answer, Tr. Vol. 1, line 25, p. 21 to line 12, p. 22). When these defenses were raised what had seemed a very clear "settlement" on September 11, 1962 became the subject to almost unbelievable equivocation and inconsistency when Sandberg's deposition was taken in resistance of a motion for summary judgment, based solely upon the admitted letters, on July 20, 1964.

Pursuant to stipulation of the parties, the Court segregated the "plea of settlement" for trial (Tr. Vol. I, pp. 31-32) on the pleadings, depositions of Sandberg and Adamek, answers to interrogatories, and the testimony of R. V. Mourer for defendants and such rebuttal as might be offered. Plaintiffs produced the testimony of Roy Countryman in rebuttal. On the record the trial court found to the effect that Waldorf and

B&W had in fact made a full settlement; concluded that the settlement with B&W also discharged Clarage (a matter apparently not disputed on this appeal) and entered judgment dismissing the complaint.

## ARGUMENT

### *Introduction:*

Appellants' counsel do lip service to the *Clark* theory of the "clearly erroneous" test, as they must in this Circuit, but this is prefaced by at least an under-emphasis of the live testimony. They then by pure *ipse dixit* characterize the result here as a "monstrous miscarriage of justice" and by every trick of advocacy seek to persuade this court to second guess the trial judge and thus, to serve their purpose emasculate rule 52(a) and the settled rule adopted in *Lundgren v. Freeman*, (C.A. 9—1962) 307 F 2d 104. They make no pretense of contending that there is not substantial evidence to support the trial court's findings, rather the thrust of their whole argument is that there is evidence and inference to the contrary and that "the reviewing court is really in as good a position as was the trial court to examine and consider the evidence on the issue in question". (Appellants' Brief, p. 7).

The fact is that this case was decided by the trial court on conflicting evidence. We think



that on every point the great preponderance of evidence, as distinct from argumentative speculation was with the Appellees and so we do not hesitate to meet Appellants head-on. Accordingly, we shall consider each of their four points in the order presented.

I. *The Writings, In the Context Under Which They Were Written, Clearly Establish A Settlement of the Fan Failures—If There was Any Ambiguity B&W's Understanding Prevails.*

A. *The Written Words.*

The idea that the August meeting wasn't had to settle everything is contrary to all that was ever written before the conference. Adamek's letter of March 27th (Exhibit "B", Sandberg Dep., p. 44) refers to Contracts Pr-58 and PFI-2799, mentions the fan failures and then suggests a meeting to "discuss and review whatever items have been tabulated" and suggests a meeting early in April. Sandberg, in his letter of April 10, 1962 (Exhibit "D", idem., p. 45) says, "We cannot be in a position to intelligently discuss *all the issues* involved for another 30 days". Later in the same letter he speaks of "all of the adjustments due us" and "any back charges and adjustments they feel are in order". Later on he says, "We are anxious to bring this matter to a close". Adamek replies on April 12th (Ex.



“E”, *idem.*, p. 47), “Re: Contracts PR-58 & PFI-2799” “After you have had an opportunity to analyze with your operating personnel any back charges and adjustments that they feel are in order”. In the letter of June 4th, (Ex. “F”, *idem.*, p. 48), Adamek repeats “any back charges and adjustments that you feel are in order”.

Sandberg’s letter of June 19, 1962 (Ex. “G”, *id.*, p. 46) is particularly significant. He apologizes for the delay caused by “so much on the fire” and vacations:

“... that I have not had an opportunity to attempt to finalize our ideas as to the adjustments we feel would be in order.

\* \* \* \* \*

“I will make every effort to get our people out there together to see if we can come up with a proposal. In any event, I will get in touch with you when I return here on June 28th.”

If, as Appellants now contend, the settlement was to cover only black and white invoices arising out of the construction—where is there room for finalizing “ideas on adjustments we feel would be in order” or coming up with a “proposal”?

The record is clear that R. V. Mourer of the Denver Service was the person who handled all of the matters arising out of the I.D. fan failures. Appellants would like to exclude him as a

principal, yet in his series of correspondence, Adamek was willing to accept some delay to have him present at the meeting (Telegram, Ex. "H", Id., p. 50).

On August 20 (Ex. "I", Id., p. 51) Adamek says he has advised "our people" to be present on August 28th to discuss the outstanding invoices, back charges, etc." Not once in this whole series of correspondence is it suggested that the conference exclude anything and the tenor of the whole clearly contemplates "power boiler" failures and the I.D. fan failures and outages.

Prior to the 7th day of September, 1962, Waldorf knew of the failure and knew of all of the apparent costs incurred by Waldorf in connection therewith. (Answer to Request for Admissions No. 2, Tr. Vol. I., p. 28).

On September 7, 1962 the admitted, outstanding and unpaid invoices for Contracts PR-58 and PFI-2799 amounted to \$25,576.66. (Answer to Request for Admissions No. 5, Id., p. 29).

On September 7, 1962, Waldorf mailed a check to B&W in the amount of \$12,788.00. (Ex. 1, attached to Request for Admissions following Tr. Vol. I, p. 27). This check was sent to bring "this account to a close." The term "this account" has reference to the first sentence of the

letter which says “regarding the settlement of our account with you on contracts SC-1378, PR-58 and PFI-2799 and our purchase order 2220.” (Ex. “A” attached to the Sandberg Dep., p. 43, is the purchase order resulting in B&W Contracts PR-58 and PFI-2799). It is conceded by all that the reference to SC-1387 was in error and was corrected by the subsequent correspondence. This check was accepted by B&W, and it is the defendant’s position that at that moment all of the charges and counter charges arising out of Contracts PR-58 and PFI-2799 were settled. In the ordinary meaning of words an account is not brought “to a close” while there are still controversies about it.

While it is conceded that there was a settlement of some kind, plaintiff contends that the settlement did not embrace the amounts due to Waldorf on account of the fan failures. Defendant takes the position that the letters in and of themselves conclusively show that the settlement did include the fan failures.

There is no suggestion in the letters that the settlement of Contracts PR-58 and PFI-2799 was anything less than final. There are no specific words leaving anything out of the settlement. As we read them, the letters indicate that if anything was settled, it was the fan failures.

These are Sandberg's words:

"You have refused to consider any allowance for Waldorf-Hoerner labor and supervision; travel expense of the writer and Waldorf, St. Paul engineering staff, Westinghouse and Clarage Fan Company servicemen's labor and material to restore the #2 I.D. fan and drive after two complete failures (the first one occurred within the one year warranty period.) We estimate that this amounts to about \$50,000 in round figures; not making any allowance for the loss of production."

"We could hardly be expected to consider this settlement satisfactory; however, we do not wish to carry on this negotiation any longer; therefore, we reluctantly have approved the payment of \$12,788.00 (this is the balance after deducting the expenses listed above from the outstanding invoices) to bring this account to a close."

(Letter, Sept. 7, 1962, Ex. 1, App. Appellants' Brief, p. 30).

If Sandberg says anything, he says that he doesn't like the settlement because he didn't get allowance for the fan failures, but certainly the letter does not exclude them from the settlement.

Before cashing the check, B&W wrote Waldorf. (Ex. 2, App. Appellants Brief, p. 31-32). The language of the B&W letter is "the amount agreed upon for Contracts PR-58 and PFI-2799." These words are general and embrace the whole of the contracts mentioned. They do

not exclude the fans or any other item. Again the letter says:

“The total of our outstanding invoices on PR-58 and PFI-2799 amounts to \$25,576.00. The amount decided upon to settle these invoices was \$12,788.00, or just half of the above total figure.”

How do we settle an invoice? We take the contract price and deduct from it the amount which the parties agree that Waldorf shall get by way of credit for its claims. There are no words of limitation here. Then B&W makes it abundantly clear that the fan failures are embraced in this settlement. B&W tell Sandberg that he got more for the fan failures than he admits:

“In reference to the last paragraph on page 1 of your letter you mentioned that we had refused to consider any allowance for Waldorf-Hoerner labor and supervision, travel expense for yourself and Westinghouse and Clarage fan servicemen for labor to restore induced draft fan on PR-58. This, I am sure is not altogether correct as we have given an allowance for Clarage service of \$620, balancing expert and instruments \$700, outside machining of fan shaft \$350, rebabbit bearings and machining \$400.”

Then in Item No. 5, B&W shows credits of \$3,078.00, all attributable to fan failure.

Then to further convince Sandberg that the settlement was good and that he had received something for the fan failures B&W says:

“Along with the above, we took care of the repair and straightening of your induced draft fan shaft in the sum of \$1500. We furnished for the induced draft fan on your Recovery Boiler two new heavier retorts made of Corten material amounting to \$7,165.00.”

Appellants now contend that the District Court paid no attention to Sandberg's words “for the completion of the contract” in Exhibit 1, and say that Sandberg was referring only to “expenses incurred before the new installation ever got into operation” as distinguished from warranty and product failures arising after operation began. Such argument is ingenious but it just will not hold water. As will be developed presently, each of the parties to the settlement made up their own specific items for the purpose of explaining the \$12,788.00 split. However, that may be, appellants just cannot get away from the fact that Sandberg's itemization (assisted by Countryman) of six items specifically does include two that unquestionably involved so-called product failures or warranty responsibility.

First, the item:

“Convert 11 soot blowers to motor drives . . . 4,180.00”. Everybody agrees that the air driven soot blowers did not prove satisfactory *in operation*, particularly because of a defect in the drive mechanism and so were replaced.

Countryman, Tr. Vol. II, p. 57,  
line 7-11;

Adamek Dep. line 15, p. 22—line  
6, p. 24;

Mourer completely dispels Appellants' argument when he explains:

“A. They were initially installed—they were of standard design made by the Diamond Power Specialty Corporation, and they were of a new design which was being supplied at that time. On the older unit, they were of older design which had been very satisfactory and they were installed properly and the unit was operating and these changes on these soot blowers occurred some months after the unit was started up. In fact, their changes in the soot blowers fell pretty much in line when we were having ID fan problems. So the soot blower changes occurred after the unit was in service, because the problem was not that it didn't operate, they just required excessive maintenance and the same thing with the fan. You might say the blade stripping off the rotor required excessive maintenance so they could operate, and so they both were in the same category.” (Tr. Vol. II, p. 37-38).

Second, Sandberg specifically listed as his last item:

“Allowance for replacement of ID fan expansion joint. . . . \$2,377.69”.

Adamek listed the same item on Exhibit 2, but he



allowed only \$900.00. Sandberg concedes that this is a place where he might have juggled figures to come up with the even 50% split (Sandberg Dep., line 17, p. 30—line 12, p. 31). In all events, there isn't any question but that the expansion joint in the very ID fan installation here in controversy was a product failure. Whatever technical interpretations counsel may now place on Sandberg's letter, he stated in his deposition:

“ . . . and the last item on there is a replacement of the suspension and expansion joints that B&W finally admitted that it was the wrong design and we replaced it at our expense.” (Sandberg Dep., p. 17, lines 11-14).

Countryman explains that the expansion joint corroded out in a matter of six to eight weeks when it should have lasted for at least five years. (Tr. Vol. II, p. 58, line 24—p. 59, line 7). There is no question but that all claims on the soot blowers and expansion joint were settled once and for all; both items failed after the plant went into operation and during the warranty period. No amount of argument or interpretation of Sandberg's words can make those failures any different in type or kind from the fan failures.

Counsel further seems to argue that when Sandberg listed his six items of credit in Ex-

hibit 1, that he “thus bracketed the payment he was making” and cites the general statute to the effect that the debtor may designate to the creditor the application of his payment. Such argument loses its effect when in a later connection counsel argue that in reality Exhibits 1 and 2 are the internal accounting records of the parties (Appellants’ Brief, pp 24-25).

It is clear that the \$12,788.00 figure did not represent specific items. It was a lump-sum figure reached by dividing the invoices in half. In Exhibit 1, Waldorf got a total of \$12,788.00 with one set of figures. In Exhibit 2, B&W justified the same total with a wholly different set of figures. The figures on Exhibit “Y”, the Countryman Memo, are not even the same as those appearing on Sandberg’s list in Exhibit 1.

What did the lump sum settle? Adamek used this language:

“I took our invoice, the total invoices, divided it in half and asked Mr. Sandberg, ‘How about this split here and just call this thing quits?’, and he said ‘Okay’ and that resulted in writing those letters.”

(Adamek Deposition, p. 18).

“Q. But I mean as far as closing out PR-58 and PFI-2799 was concerned, that closed the books?

“A. That’s right.

“Q. On these original invoices?

“A. On all that we had discussed.

“Q. These invoices that are referred to here in his letter of September 7th?

“A. Those invoices plus anything else that had been discussed at the time, our service department or Mr. Sandberg, we had split this in half, ‘You close your books. We’ll close ours.’ ”

(Adamek Deposition, p. 22).

Even Sandberg admits that the items in his letter of September 7th had no particular reference to the whole controversy:

“Q. Let me ask you this, now. This \$12,788.00 figure was arrived at first as a compromise and exactly one-half of the amount of outstanding B&W invoices on those two contracts?

“A. It was arrived at as I recall, as the matter of settlement and negotiation on the invoices. It was a matter of settlement and, as I recall, had no reference to the particular items involved in here.

“Q. That is right, it wasn’t. You weren’t taking each item and juggling it back and forth; you picked a \$12,788.00 figure to settle ‘the whole ball of wax’ is about what happened?

“A. I’m not sure. It is possible.”

(Sandberg Dep., p. 31, lines 13-25).

The question here is what the parties had in mind when they made their lump-sum settlement

for the very reason that they were bogged down on specific items—not the arbitrary figures either party used to justify the lump sum. That is not to say that the several fan failure items listed by Adamek in his Item 5, Exhibit 2, and by Mourer in Exhibit “X” are not persuasive—they are because they show the intention of the parties and are the promptly recorded recollections of Adamek and Mourer as to the general subjects which were involved in the settlement discussion of August 29. Just as Sandberg’s two whole paragraphs on the fan failures in Exhibit 1 show conclusively that they were contemplated in the settlement by him. (Note that Countryman believed the first fan failure was a “back charge” (Tr. Vol. II, p. 22, lines 4-9)).

B. *If there be any ambuquity, Appellants are bound by what Sandberg knew he had led Adamek to believe.*

The evidence is clear that no one ever stated that the fan failures were to be excluded from the settlement. Adamek testified:

“Q. When you say you had settled it half and half, did anybody suggest in your meeting in any words in the meeting itself that there was something left out of the settlement?

“A. Not to my knowledge.”

(Adamek Deposition, p. 48).

Mr. Countryman conceded that his own

mental reservations as to the fan failures were not communicated to Adamek or Mourer, either by him or by anyone else (Tr. Vol. II, p. 63, line 14—p. 64, line 3).

Sandberg, of course, stoutly maintains that fan failures were not even mentioned at the meeting on August 29th, but had real difficulty explaining why he devoted two whole paragraphs to them in his letter written within 10 days after the conference. He said:

“Q. And you told me, I think you said a moment or so ago in response to a question that you can’t now recall just what was in your mind at the time of this September 7th letter; is that correctly quoting you?

“A. I certainly had in mind the failure of the fans but my reason for inserting this particular paragraph in there, I don’t recall.”

(Sandberg’s Deposition, p. 36,  
lines 2-8).

When he read Adamek’s letter of the 10th he knew that Adamek had fan failures in mind because many of the items, and particularly Item 5, could relate to nothing else (Sandberg Dep., p. 38, line 10 to line 10, p. 40). He then admits:

“Q. So that you knew when he wrote you back with his letter of September 10th that he was thinking in terms of these

fan failures, did you not?

“A. That is right.

“Q. So then, when you wrote your letter of September 11th, did you do anything in that to correct the misunderstanding that he had?

“A. No sir.”

(Idem., p. 40, lines 11-18).

Even if there were nothing else, Section 93-401-21, R.C.M., of 1947 is controlling here. That section provides:

“When the terms of an agreement have been intended in a different sense by different parties to it, that sense is to prevail against either party in which he supposed the other understood it, and when different constructions of a provision are otherwise equally proper, that is to be taken which is most favorable to the party in whose favor the provision was made.”

It doesn't matter what secret reservations Sandberg may have now conjured up, or had suggested to him, to avoid the effect of the settlement he made. The law just will not permit this kind of double dealing. The underlying morality of that rule is picturesquely stated by the Supreme Court of Montana in *Kintner, et al, v. Riggs*, (Mont. 1965) 408 P 2d 487 at 495, as follows:

“Professor Wigmore, in his work on Evidence (3rd ed.) section 2466, submits a story taken from the works of Dr. Wm. Paley, Principles of Moral and Political Phil-

osophy, b. III, p. I, C.V., 'Promises', which well illustrates the situation. . . .:

“ ‘Temures promised the garrison of Sebastia, that if they would surrender, *no blood should be shed*. The garrison surrendered; and Temures buried them all alive. Now Temures fulfilled the promise in one sense, and in the sense too in which he intended it at the time; but not in the sense in which the garrison of Sebastia actually received it, nor in the sense in which Temures himself knew that the garrison received it; which last sense, according to our rule, was the sense in which he was in conscience bound to have performed it.’ ”

II. *The Oral Testimony Bolsters the Writings as a Full Settlement.*

Appellants' treatment of this subject under the heading indicating that the "principals" testified there was no settlement of fan failures. At the outset let it be pointed out that while Adamek took the lead in the discussions with Sandberg he was not the principal representative of B&W in any instance where failures or problems after the commencement of operation were encountered. That was the sole province of R. V. Mourer who was at the conference to discuss such items. The Adamek deposition is very clear on this point as is the whole record. Appellants cannot by talking about principals or "carrying the ball" relegate Mourer's clear



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testimony that there was a complete settlement to a secondary position.

Appellants contend that *both* Adamek and Sandberg swear that they did not negotiate and settle the fan failures. The record does not support that bold assertion as to either man. As to Adamek, counsel really “hang their hat” on a single question and answer in the Adamek Deposition, disregarding all else in the deposition. It is true that Adamek was asked and answered:

“Q. Let me ask you whether in the course of this meeting there in August of 1962 you and the service department and Mr. Sandberg undertook to discuss and negotiate out any liability of either your company or the Clarage Fan Company on the warranty for the induced draft fan or responsibility for the failure of the fan?

“A. Not that I recall.”

(Adamek Deposition, p. 35).

It is obvious from his whole deposition that Adamek was misled or did not understand that carefully contrived trap question which involved more questions of law than it did fact. For example, only a few moments before, Adamek had been asked and answered:

“Q. Now, at this same meeting did you discuss the matter of responsibility for the failure of these induced draft fans?

“A. I’m sure our service department did be-

cause they supplied free of charge two new wheels for the fan.”

In terms of fan “failure”, as distinct from the technicalities of warranty, Adamek testified on his cross-examination:

“Q. Do you remember whether anything was said with respect to the failure of the induction draft fans?

“A. I’m sure that we discussed at that time, or it was discussed at that time the trouble they had had with the fans.

“Q. Were these discussions largely between you and Mr. Sandberg or between Mr. Mourer and Mr. Sandberg?

“A. They were mostly between Mr. Mourer and Mr. Sandberg.

“Q. As of the time of that meeting did you yourself have any intimate knowledge of the various failures and the various charges and counter-charges which were being discussed?

“A. I knew of the failures but not charges or moneys or anything involved.

“Q. Were Mr. Mourer and Mr. Sandberg in agreement about where the responsibility of Babcock & Wilcox for various items was?

“A. It appeared to me they were.”

(Adamek Deposition, p. 42).

Further at page 44:

“Q. Now, does that recall anything to you with respect to the conversation between Mourer and Sandberg as to

whether or not they had discussed the responsibility for the fan failures at your meeting?

“A. I can’t recall any specific statements or any thing, but the responsibility for the fan failure, since it happened within the one year period and we have a one year warranty on material, is definitely Babcock & Wilcox’s responsibility to replace it.

“Q. Yes, but was there a discussion about this?

“A. I can’t recall.

“Q. Was there a discussion about what the service department had done toward replacing this?

“A. Yes, there was.

“Q. Was that part of the August meeting?

“A. That was a part of the August meeting.”

(Idem., line 22, p. 44 to p. 45, line 12).

It is to be noted that counsel for the Appellants set forth the above testimony on pages 18 and 19 of their brief down to the “I can’t recall” answer but apparently deliberately seek to distort the whole meaning by the purposeful omission of the last two questions and answers.

Finally, the whole substance of Adamek’s version of the August meeting and the settlement reached is summed up in the sworn deposition,

likewise carefully ignored by counsel, as follows:

“Q. What were your words as nearly as you can remember them?

“A. Something on this order: ‘We’ve been going on for a day and a half here and we seem to have not come to any settlement yet. I would like to suggest that why don’t we take the amount of our invoices and we’ll split it in half and if it’s agreeable with you it’s agreeable with us, and we’ll close this thing off.’

“Q. When you say close it off you were talking about what contracts?

“A. I’m talking about the meeting held for PR-58 and PFI-2799.

“Q. And one of the things that you knew about and one of the things that Sandberg knew about with respect to the PR-58 at that time was the fact that the fans had failed, was it not?

“A. Oh, that was our knowledge, everybody’s knowledge.

“Q. And included in your acceptance letter there are credits given to them on account of those fan failures, are there not?

“A. That’s true.”

Sandberg’s deposition was, of course, taken after Lumbermen’s had come into the picture and learned of the settlement that had been made. It is true that Sandberg did deny the settlement on his sworn deposition but that doesn’t mean that the trial court had to believe him,

especially when he just could not square the contents of his letter of September 7th, written before Lumbermen's entry, and his testimony after the insurance company came in. For example, Sandberg said:

“Q. Let me put it this way, didn't you and Mr. Adamek and Mr. Mourer agree on a figure of \$12,788.00 and then set out to justify it somehow?

“A. I don't think so. I think these figures are exact.”

(Sandberg Deposition, p. 30).

If Sandberg knew anything, he knew that the \$12,788.00 figure was not exactly anything. In Exhibit 1, he managed to come up with a \$12,788.00 figure. But his figure did not embrace the items Countryman says were discussed, and even when the same items are mentioned the figures are not the same. (Compare Exhibit 1 and Exhibit “Y”).

Sandberg says, referring to his letter:

“Q. So, when you said that ‘we could hardly be expected to consider this settlement satisfactory’, you were saying, ‘it is not satisfactory in light of the money that you had expended in connection with the No. 2 ID fan’; isn't that so?

“A. No, sir, that is not so.

“Q. All right, tell me then what that language meant?



“A. It meant that the settlement for the power boiler that they refused and the other items that B&W had refused to consider as their responsibility.”

The power boiler failure was not mentioned in the letter. Yet he says that is what he was complaining of.

Then, he says that they drove a hard bargain (Dep., p. 30, lines 9-12) and that this again referred to the not-mentioned power boiler. Then he finally gets around to the idea that the fan failures were not settled because they were not mentioned in the August 29th meeting (Dep., p. 34, lines 12-15), but at the same time he admits that the letter related not only to the August conference but to matters which had been previously discussed. (Dep., p. 29, lines 26-30).

At one time Sandberg admits the possibility that he settled the whole controversy.

“Q. Let me ask you this, now. This \$12,788.00 figure was arrived at first as a compromise and exactly one-half of the amount of outstanding B&W invoices on those two contracts?

“A. It was arrived at as I recall, as the matter of settlement and negotiation on the invoices. It was a matter of settlement, and as I recall, had no reference to the particular items involved in here.

“Q. That is right, it wasn't. You weren't taking each item and juggling it back and forth; you picked a \$12,788.00 fig-

ure to settle 'the whole ball of wax' is about what happened?

“A. I'm not sure. It is possible.”

(Deposition, p. 4, lines 13-25).

At one point he says that he settled all of the controversies.

“Q. Now, you are talking about a settlement in the first sentence; are you not?

“A. That is right.

“Q. Where they cut down their bill \$12,788.00 and you pay them \$12,788.00 to settle all the controversies between you on PR-58 and PFI-2799. Isn't that what you said in that paragraph and isn't that what you meant?

“A. As far as the contracts, this is settlement of the two contracts, yes.

“Q. And you had in a previous paragraph mentioned the ID fan failures, the loss in production, you had mentioned allowances for Waldorf-Hoerner's labor, travel expenses, Westinghouse and Clarage service in repairing the two ID fans; had you not?

“A. Yes.

“Q. You were conscious of the cost of the repair and of those fans, were you not?

“A. I was conscious of it, yes.

“Q. And you also were aware that the failures or that the first failure had occurred within the warranty period, were you not?

“A. Yes.”

(Deposition, p. 32, lines 5-26).

Then Sandberg says that the mention of the fans in his letter is a mistake, because nothing was said in the conference about fan failures (Dep., p. 34, lines 6-15); then concedes that the letter references were to the fan failures, (Dep. 34, lines 27-30), and finally winds up saying that he didn't know what he was doing.

“... just what consideration I was giving to the liability of B&W at the time, I, when I approved these invoices, I don't know. I don't recall exactly.”

(Deposition, p. 35, lines 14-16).

“Q. And you told me, I think you said a moment or so ago in response to a question that you can't now recall just what was in your mind at the time of this September 7th letter; is that correctly quoting you?

“A. I certainly had in mind the failure of the fans but my reason for inserting this particular paragraph in there, I don't recall.”

(Deposition, p. 36, lines 2-8).

On the other hand, Mourer, who appellants would like to ignore, gives a very clear and reasonable explanation of the very matters covered in the conference which Sandberg, in Exhibit 1, complained were not allowed in “this settlement” (Tr. Vol. II, p. 17, line 15 to p. 18, line 22) and is explicit that the whole purpose of the

meeting was “to settle all outstanding differences” so B&W could be finally paid (*Id.*, p. 11, lines 9-22).

### III. *Substantial Consideration.*

Appellants’ argument here is that reducing Waldorf’s obligation by one-half to the tune of \$12,788.00 is not enough to make a settlement likely. All this amounts to is a repetition of Sandberg’s protest made at the time, “We could hardly be expected to consider this settlement satisfactory; etc.”

At the outset, let it be clear that when Appellants talk about \$50,000.00 of liability they are talking about a demand in a complaint. When counsel talk about \$29,267.00 being not practically in dispute, they are greatly in error; the fact is that on the merits of the claims Appellees have denied legal responsibility and liability for even \$1.00. The whole argument of contrasting a claim in large figures with a comparatively small settlement can be compared to the personal injury claimant demanding several hundred thousand dollars for a mild whiplash.

Whatever Waldorf may have spent, or claimed to have lost, was not the question—the question in these negotiations was only how much B&W might be legally responsible for under its warranty or otherwise. The fact is that all we

know of the warranty is what is set forth in the complaint, ie., B&W would repair and replace within one year any equipment which was defective in design, workmanship or material (Complaint, par. III, Tr. Vol. I, pp. 7-8). That warranty did not, as Mourer pointed out, include a lot of overtime costs in making speedy repairs (Tr. Vol. II, p. 18).

It is apparent from the record that this product liability or warranty claim was doubtful and disputed and was so considered by both Sandberg and Countryman. Sandberg testified that he knew as much about the cause and responsibility for the claim on September 7, 1962 as he knew when his deposition was taken after this suit was filed; there was much discussion and speculation as to the reason for the fan failures but that had never been really determined; he had taken the position that B&W was responsible (Dep., pp. 25-27) but as to actually pinpointing responsibility he testified:

“A. Well, I would—responsibility to Waldorf—I don’t see how I can make a statement that they are responsible if I don’t know the reasons for it. So I can’t see that I can accurately place the responsibility without knowing more, without having more certain facts of actually what happened.”

(Deposition, p. 27, lines 11-16).

Countryman doesn't fix responsibility either (Tr. Vol. II, pp. 59-60); he describes several things, some of them as likely to be caused by the method of operation as by any deficiency in the fan; then seems to settle upon defective operation of washing equipment and winds up:

“A. You see, I can't make a flat statement that the fan failure was definitely attributable to this one item, nor do I think anyone else can, you see, because there were several factors that contributed to the fan failure.”

(Tr. Vol. II, p. 61, lines 2-6).

It follows that the two men who represented Waldorf knew in their own minds that maybe it really didn't have much of a claim for the fan failures. Who, other than the negotiators themselves, is to say what is “substantial” on a doubtful and disputed claim? In addition to foregoing one-half of the balance due, B&W supplied two Corten rotors for the fan costing \$7,165.00, paid \$1,500.00 to straighten the fan shaft and paid the C. C. Moore bill for \$3,236.72 (Exhibit 2)—a total of nearly \$12,000.00 additional to cutting its contract debt in half.

The fact that Lumbermen's has now come on the scene, or that a substantial insurance payment, unknown to B&W, may have softened Sandberg in his demands does not change the fact that Sandberg did rather quickly snap-up Adamek's

50-50 offer.

The consideration for an accord and satisfaction need not be adequate. *Brent v. Westerman*, D.C. Mo., 123 F. Supp. 835.

IV. *There Is Nothing Incredible About the Transaction.*

Appellants seem to argue that there just couldn't be a settlement in the absence of the insurance company. The great fallacy of that argument, at least so far as B&W is concerned, is that there was no knowledge or notice whatsoever of any insurance payment or any subrogation rights. The one issue before the trial court was whether Waldorf had made a settlement. In the posture of this case Lumbermen's must stand and fall with Waldorf. When the settlement defense was raised Lumbermen's did not come in, as it might have if it thought the facts warranted, to show that the pleaded settlement had been made to defraud the insurance company or that it was made with notice or knowledge on the part of B&W that subrogation rights had attached. Such was not done. Indeed, counsel have been strangely coy about the whole insurance matter and on the record here we don't even know *when* Lumbermen's made its payment. All the complaint says is that as of March 29, 1963 Lumbermen's "has paid Waldorf." This is over six months after the critical time.



If we follow the lead of Appellants' counsel and apply Nizers rule of probabilities as a guide to the truth, then, actually the belated appearance of Lumbermen's has a tendency to explain many things. It completely dispels the substantial consideration argument because if Sandberg knew that Waldorf had been paid or would be paid by the insurance company, then in his position in August and September of 1962 the fifty per cent concession obtained by just dragging his feet was pure velvet. Counsel mention that no facts were assembled or discussed in detail. This is true of Sandberg both at the March and August meetings. It is not true of Adamek and Mourer and the latter made it very plain that he was prepared and would have "gone down item by item all the way through to the bitter end." (Tr. Vol. II, p. 31).

It also explains Sandberg's desperate equivocation and confusion. If, without the knowledge of Adamek, Waldorf had already been paid for the fans or even expected to be paid by its own carrier, then Sandberg believed he was really making a very shrewd and clever business deal when he got a chance to settle for half of his indebtedness. After dragging the matter for nearly two years, as his correspondence with Adamek will indicate, he really "snapped up"

Adamek's hesitant and very tentative suggestion in frustration that they just cut the bill in half. Only after the suit was filed and the defense raised did he find that the insurance company was quite unhappy and he was forced to evade and explain the damning paragraphs in his letter written within ten days after the August meeting.

If, as counsel assert, there has been a "monstrous miscarriage of justice" which "shocks the conscience" that was all engineered by Sandberg and he and Waldorf should bear the consequences. We again emphasize that however unfortunate Lumbermen's position may be it arose because it either slept on its rights or paid without proper inquiry—in all events, its rights or equities are no greater than Waldorf's.

### CONCLUSION

We most sincerely urge that the trial court's findings and judgment are not "clearly erroneous" and that under the rule adopted by this Court it may not second guess the trial judge. Furthermore, on the record here, the evidence so greatly preponderates in support of the trial court that it really could arrive at no other result. B&W settled all claims for the fan failures with Waldorf as of September 11, 1962 and the fact that Lumbermen's is now in the picture does not change that result, or its consequences.

Respectfully submitted,

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### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

.....  
Attorney

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# UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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LUMBERMENS MUTUAL CASUALTY  
COMPANY, an Illinois Corporation, and  
WALDORF-HOERNER PAPER PRODUCTS  
COMPANY, a Montana Corporation,  
Plaintiffs and Appellants

— vs. —

BABCOCK & WILCOX COMPANY, a New  
Jersey Corporation, and CLARAGE FAN  
COMPANY, a Michigan Corporation,  
Defendants and Appellees

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Appeal from the United States District Court  
For the District of Montana  
Missoula Division

## BRIEF OF APPELLANTS

Lumbermens Mutual Casualty Company  
Waldorf-Hoerner Paper Products Company

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WM. B. LUCK, CLERK

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Filed: \_\_\_\_\_, 1966

\_\_\_\_\_, Clerk





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## STATEMENT OF JURISDICTION

This action was originally commenced in the District Court of Missoula County, Montana, wherein the plaintiffs (citizens of Montana and Illinois) claimed damages of \$50,993.00 from the defendants (citizens of New Jersey and Michigan) for breach of warranty and for product failure. (Complaint, Tr. I, p. 8).

The defendants removed the cause to the United States District Court by reason of diversity of citizenship, under 28 U.S.C.A. 1332 and 1441. (Petition for removal, Tr. I, p. 4).

Final judgment was entered January 17, 1966, dismissing the plaintiffs' complaint on the merits with prejudice. This appeal is taken from that judgment, under 28 U.S.C.A. 1291. (Notice of Appeal, Tr. I, p. 47).

## STATEMENT OF THE CASE

The question raised by this appeal is whether the liability of the defendants on product warranty and for product liability was compromised and settled as a part of an agreed settlement of contract adjustments on the balance owing for the original installation of a \$1,250,000 wood pulp recovery process.

This compromise and settlement issue was pleaded as an affirmative defense against the complaint for product liability, and was tried separately in advance by the court without a

jury, pursuant to stipulation of counsel. The Court found that the product liability was included in the settlement, and entered judgment finally dismissing the plaintiff's action on the merits with prejudice. We appeal from this judgment.

A brief chronological history of the matter is:

December, 1959—Defendant Babcock & Wilcox Co. (B & W, hereafter) contracted with plaintiff Waldorf-Hoerner Paper Products Company (Waldorf, hereafter) to furnish and install in operating condition a wood pulp recovery unit for a total price of \$1,238,484.51, one portion being a "recovery boiler" and one portion being a "power boiler."

September, 1960 — The units were installed and commenced operation, so that the one-year warranty on the product came into effect.

March 30, 1961—A large induced draft fan in the recovery boiler spun apart and failed, causing a loss of \$29,267.84, of which plaintiff Lumbermen's Mutual insured all but \$1,000.00.

October 28, 1961—A second failure occurred in the same induced draft fan assembly, causing a loss of \$21,726.99, of which again Lumbermen's insured all but \$1,000.00.

August 28, 1962—A settlement conference was held in Missoula, Montana, between Waldorf and B & W, wherein B & W was claiming a balance due on the original contract of \$25,576.00, and

Waldorf was claiming offsets against that balance. By agreement at the conference, Waldorf paid B & W \$12,788.00, transmitting this payment with a letter shown in the transcript as Exhibit 1, (Tr. I, following page 28).

Note: Since Ex. 1, 2 and 3 are key documents in this case, we have reproduced them in the appendix to this brief for easy reference.

May, 1963—This action was commenced to recover on the subrogation rights of Lumbermen's.

The issue involved here was segregated for trial and submitted to the Court upon two depositions including the correspondence between the parties, and the testimony of two witnesses who were presented in court. The principals at the conference were Sandberg for Waldorf and Adamek for B & W, and these are the witnesses who testified by deposition. The court witnesses were Mourer and Countryman, who both agreed they were there only to assist. In the course of our argument we will point out that the Court's Findings are based upon the evidence in the depositions and correspondence, so that the reviewing court is really in as good position as was the trial court to examine and consider the evidence on the issue in question.

The entire dispute depends upon whether the parties in truth and in fact lumped together the adjustments arising from the original construc-

tion of the installation and the liabilities arising from the two product failures occurring six and thirteen months after the completion of the installation. Appellants contend that the settlement embraced only the adjustments arising from the construction process, and that no one at the settlement conference undertook to evaluate and settle the warranty liability of \$29,267 and the product failure liability of \$21,726.

The record shows without dispute that the offsets and backcharges asserted by Waldorf as adjustments on the original contract price exceeded the \$12,788 finally paid in settlement, and further shows that nowhere in the writings was there a single word from Waldorf to the effect that Lumbermens' subrogation claims were being included in the settlement. The record will show, therefore, that if the \$50,994 of warranty and product failure losses were included in the settlement, they must have been included for an absolutely nominal amount. The record shows that B & W does not dispute its warranty, while if this judgment is affirmed it will escape therefrom scot-free, a result so abnormal that the injustice and error in it are certainly manifest.

By the foregoing we are endeavoring to illustrate that there were two natural and normal areas for settlement discussion between the parties, and that the actions and communications of

the parties must be interpreted within these dual frames of reference. The detail of our argument will be to show that the warranty and product liability area was never in fact included in the settlement negotiations. The District Court's Findings VIII and IX (Tr. I, p. 44) are clearly erroneous, and should be set aside.

### SPECIFICATION OF ERROR

1. The Court erred in making its Findings of Fact (Tr. I, p. 42-44) and Conclusions of Law (Tr. I, p. 45) adverse to the plaintiffs, especially in that:

By Findings of Fact VI, VII and VIII, the Court holds that the parties consolidated all their differences as to claims and liabilities into one subject, one conference, and one settlement, and these are so contrary to the evidence in the record as to be clearly erroneous under Rule 52(a). The Court should have found that the parties segregated their differences into (a) those relating to the completion of the original wood pulping process installation, and (b) those relating to later product failures which were subject to insurance protection, special warranty, and general product failure liability, and that the settlement made by the parties covered only (a) so that it would not bar the present action for (b).

These Findings are contrary to the express personal testimony of the two adversary princi-



pals, and to all the evidentiary probabilities in the case, as will be explained in argument, and are therefore clearly erroneous under Rule 52(a).

By Finding IX, the Court holds that the position of the plaintiffs as set forth in its letter of transmittal of final payment was modified by the defendants' letter of response thereto, so as to bind the plaintiffs to the position of the defendants, whereas the Court should have found from the face of the letters themselves that the plaintiffs' position was expressly made applicable to (a) above, and that this limitation to (a) was not disaffirmed or modified by the defendants so as also to include (b), it being the duty of the defendants rather than the plaintiffs so to do. For this reason the Finding is clearly erroneous under Rule 52(a).

By Conclusion of Law II and III, the Court holds that the plaintiffs' "claims on account of the contracts . . ." and "the original obligations of the parties . . ." under the contracts were settled, (Tr. I, p. 45) and that these included the (b) liabilities which arose six and thirteen months later under express warranty and product failure law. It was clearly erroneous to conclude that settlement of the "original obligations" included the later fan failure obligations which have a legally different basis of liability, and which were

excluded by the terms of the plaintiffs' letter of transmittal of payment, Ex. 1.

2. The Court erred in entering judgment on the merits dismissing the plaintiffs' cause, because its Findings and Conclusions are not supported by the evidence for the reasons set forth in Paragraph 1 above, and are therefore clearly erroneous.

## ARGUMENT

### Introduction

The substantial evidence in the record is all in documentary form, and was considered by the District Court exactly as this Court is considering it. The two witnesses the Court heard in live testimony were the assistants to the principals, Sandberg and Adamek, and were presented simply so that all persons who participated in the August settlement conference would have been heard from. The depositions of the principals were taken, reviewed and corrected by them, signed and sworn to, and therefore represent the true, first-hand, considered statements of the positions of their companies.

We acknowledge our burden on this appeal, under Rule 52(a) and

*Lundgren v. Freeman*, 307 F.2d 104,  
to show that the findings are clearly erroneous, despite the weight to be given to the District Court's initial consideration of the facts. How-

ever, we believe we can carry this burden in this particular case, due to the monstrous miscarriage of justice which has occurred here.

We shall undertake this by making four specific points:

1. There is no statement in the writings between the parties to the effect that the warranty and product liability claims are *included*, while the settlement detail from Waldorf in Ex. 1 *excludes* them by its explicit inclusion of other items totaling the \$12,788 compromise payment.

2. The two principals who would have negotiated the settlement of these claims if they were settled *both* swear this was not done. (The District Court's finding VIII is absolutely contrary to this testimony from both parties, and is therefore not supported by any evidence.)

3. No substantial consideration of any kind was paid or received for the settlement of claims totaling over \$50,000.00, one of which was based on undisputed warranty that should not have been subject to discount.

4. It is improbable, and in fact incredible, that experienced businessmen would have included the warranty and product liability issues in the settlement when

- a. Waldorf was thereby destroying Lumbermen's rights without its representation;
- b. Adamek was going completely outside the

province of the Sales Department;

- c. There was no effort even to ascertain the amounts involved under the warranty;
  - d. Normal releases of claim from Waldorf to B & W, Clarage Fan, for their insurers, their business records, etc. were not obtained.
1. *The writings do not establish a settlement of the fan failure claims.*

Sandberg's letter of September 7, 1962, Ex. 1, is not a model of clarity in expression, perhaps, but in the context of previous correspondence and relations between the parties it is easily understood. In the second paragraph he lists six items with amounts totaling \$12,788.00 as out-of-pocket costs supplied by Waldorf for the completion of this project, and sends the check for the difference between those items and B & W's conceded contract balance.

The District Court paid no attention to his wording "for the completion of the project." Sandberg was referring to expenses incurred before the new installation ever got into operation, which is to be markedly distinguished from warranty and product failures arising six and thirteen months later. Thus, on the written record, Waldorf stated that the payment was for items involved in the "completion" of the project, which automatically excludes items arising long

after completion. We want to make it clear that not only did Waldorf say nothing to the effect the warranty and failure issues were included in the settlement, but it clearly said the settlement was composed of items involved in the completion of the project.

As we will show more in detail under Point 3, every dollar of the six items listed in this letter were unquestioned, legitimate backcharges or offsets, and therefore cannot be a cover-up for the liabilities in issue here. Surely, if these men had openly and consciously negotiated a total settlement which included the product failure liabilities, this letter would have unmistakably said so and would have been in different form. Ordinary honesty and accuracy would cause the letter to reflect the agreement, for certainly if it was a genuinely agreed to settlement there would be no point in disguising it.

Much was made by our opponents of the succeeding paragraph in Ex. 1, where Sandberg says no allowance has been made for the fan failure, etc., and he does not consider the settlement satisfactory, as though those statements prove that settlement of the product failures was negotiated and included. The Court cannot fail to get from those statements that in the mind of the writer *no* payment or allowance had been made on those items, and that is the point—if *no* allowance or

payment is made for them, then they had not been settled. Since the other items were all legitimate, it follows of necessity that if the settlement reference included everything, then \$50,000 of liability claims, \$29,267 on a clear written warranty, were disposed of for *no payment at all*. These words cannot reasonably be interpreted as expressing that result.

At this point we ask the Court to examine very closely these closing letters, Ex. 1 and 2. Sandberg in Ex. 1 in the plainest terms acknowledges the \$25,576 owing on the contract, lists his six items for \$12,788 of backcharges, and sends his check for the difference. By the most explicit words, all this is related to the original transaction. He uses the words "outstanding invoices on the above purchase order," and "out-of-pocket costs . . . for the completion of this project." The payment is of \$12,788 as "the balance after deducting the expenses listed above from the outstanding invoices to bring this account to a close."

We contend that when Sandberg thus bracketed the payment he was making, the payment was by law limited to that bracket unless changed after formal rejection by B & W upon being received. If that bracket was unacceptable to B & W, it should have sent the check back, or demanded a change in the bracket.



Now the Court should turn to Ex. 2, B & W's reply. It accepts the payment as "the amount agreed upon for Contracts PR-58 and PFI-2799." Those contracts cannot in any way be found to embrace warranty and product failure claims arising long later, and thus B & W accepted Waldorf's bracketing of the payment.

Its later language, demurring to the charge that B & W had done nothing about the fan failures, is in no respect a rejection of Waldorf's terms of payment already accepted in the first paragraph. This is made finally clear by the closing paragraph where the *only* reason the Waldorf payment was not passed on to the Treasury was the inadvertent reference to the Contract SC 1387.

Montana codifies the general rule on application of performance by

Section 58-407, R.C.M. 1947:

*"Application of general performance.*

. . . . .

1. If, at the time of performance, the intention or desire of the debtor that such performance should be applied to the extinction of any particular obligation, he manifested to the creditor, it must be so applied."

. . . . .

The stating of that correction and the omission of any other correction makes it inevitable that under the applicable law the payment of \$12,788



was limited to the closing of the original purchase order and the completion of the project. It is therefore legally impossible to contort the language used into the inclusion of two separate and distinct types of liabilities that had no reference whatever to the completion of the project, and never even arose until long after the project was completed and in operation.

The Court's Finding IX is therefore clearly in error, for it was not Waldorf that "proceeded with the settlement" on B & W's terms in Ex. 2, but B & W that proceeded with the settlement on Waldorf's terms in Ex. 1.

2. *The principals testify there was no settlement of fan failure claims.*

The principals were Nels Sandberg, chief executive of Waldorf, and Frank Adamek, Sales Manager of B & W for the Waldorf territory. They signed the letters, Ex. 1 and 2. Adamek perfected the arrangements for the meeting (Tr. II, p. 31, 1. 8) and was "carrying the ball all the way through," as distinguished from the witness Mourer (Tr. II, p. 29, 1. 19). The settlement of 50-50 was his suggestion, not Mourer's. (Tr. II, p. 31, 1. 11-18).

If a settlement of the product liability issues was made, it had to have been voluntarily and consciously negotiated and agreed upon by these two men. In Finding VIII the District Court

found that these two men used language "appropriate to effect that intention."

We here set forth the testimony of these men as it is in their signed depositions, which this Court can read as readily as did the District Court.

(Deposition of Frank A. Adamek, p. 35, 1, 5, ff)

"Q. Let me ask you whether in the course of this meeting there in August of 1962 you and the service department and Mr. Sandberg undertook to discuss and negotiate out any liability of either your company or the Clarage Fan Company on the warranty for the induced draft fan or responsibility for the failure of the fan?

A. Not that I recall.

Q. And this would not have been a province of the service department, I take it?

A. I don't believe it would be.

Q. And really it would not be a part of the function of your department, the sales department?

A. That's true."

(Deposition of Frank A. Adamek, p. 44, 1, 22, ff)

"Q. Now, does that recall anything to you with respect to the conversation between Mourer and Sandberg as to whether or not they had discussed the responsibility for the fan failures at your meeting?

A. I can't recall any specific statements or

anything, but the responsibility for the fan failure, since it happened within the one year period and we have a one year warranty on material, is definitely Babcock & Wilcox's responsibility to replace it.

Q. Yes, but was there a discussion about this?

A. I can't recall."

Then Mr. Sandberg:

(Deposition of Nels Sandberg, p. 22, 1. 13, ff)

"Q. In the back charge items which you discussed with B & W on the occasion of this August 28th meeting; were there included any amounts at all with reference to the failure of the induction fans as you have described them?

A. None whatever.

Q. Was there negotiations between you and Mr. Adamek as to whether B & W was liable for that failure or Waldorf was liable for the failure or whether anybody was liable for the failure?

A. No.

Q. Was there any discussions between you and Mr. Adamek concerning responsibility on the part of B & W under any warranties that accompany the contract of installation for the recovery boiler?

A. Not at that time."

(Deposition of Nels Sandberg, p. 28, 1. 15, ff)

"A. I say again, September 7, 1962, the discussion of the failure of these fans did not come up under adjustment as to who was responsible; who was responsible

was not discussed and Waldorf at no time had invoiced B & W for anything trying to recover any expenses that we had gone to.”

We believe these statements by Mr. Adamek are really conclusive of the issue. The question to him was clear and explicit, and his answer unequivocal. They not only did not negotiate these liabilities to settlement, it would have been beyond their province to do so. These are not unconsidered answers, either, for Mr. Adamek read over, corrected, and then signed his deposition, so that the position he took is unquestionably correctly stated.

We also believe it helpful to review the earlier correspondence between Sandberg and Adamek, most of which is attached to Adamek's deposition. These show that the two men had a clear working relationship, an ability to express themselves understandably, and that they had the same concept of what they were calling “settlement.” With them it was not the same as with lawyers, who use “settlement” in reference to controversy. With Sandberg and Adamek, settlement referred to the adjustment of the various charges and unusual expenses or happenings that occur in the course of a large construction project, so as to determine the ultimate final balance on the contract price.

This is conclusively demonstrated by refer-

ence to the letters of March 20, March 30 and April 3, 1961, passing between Sandberg and Adamek, which are a part of Adamek's deposition. The reason these are important is that they antedate consideration of any fan failure, and yet show that the parties were planning about getting together to "settle not only this matter but also begin to negotiate the final settlement of the No. 2 recovery unit." These make it perfectly clear that Sandberg and Adamek were discussing invoices that were referable to the original contract of purchase and installation, and that when they speak of "settling" it is with direct reference to the initial contract obligation and not to subsequent issues of breach of warranty and product liability.

The correspondence between the parties runs from March 20, 1961 until September 10, 1962, a period of 18 months. The Court cannot read the entire exchange of correspondence and get from it the slightest reference by the parties to the inclusion of warranty liability or product liability within the scope of negotiation and "settlement."

As we have been saying, there were two subjects for settlement, one the original price less usual backcharges and two, the warranty and product failure items primarily belonging to the plaintiff insurer. Sandberg and Adamek were

dealing and speaking in reference to their normal province, the original contract less adjustments, and their letters must be read in that context. This makes it perfectly understandable and reasonable that in the August meeting they talked about those items and did not talk about the claims now in suit. Since this is what they did at the meeting, so also it is what their letters mean in their reference to “settlement.”

3. *No substantial consideration was paid for a settlement of fan failure losses.*

In normal business affairs, debts are paid at par and warranties are made good to the same extent. When a firm like B & W warrants a million-dollar installation, and a failure occurs within the warranty, it is normal to expect that it would make good the loss. Here was a loss of \$29,267, of which Lumbermens paid \$28,267, and for the purposes of this case we can assume that this was a correct figure.

The product failure was beyond the warranty period but involved a second and similar failure of the same fan, and it cost \$21,726. Again, for the purposes here it has a face value of that sum, though legal liability may be more difficult to establish than warranty liability.

While we contend these claims for \$50,000 were not discussed or included, under the Court's findings these would be added to the other items

in issue between Sandberg and Adamek at their meeting. Let us now consider these other items so as to determine what was in issue. In Sandberg's deposition, pages 15 to 20, is a description of them, including the ones enumerated in Sandberg's letter, Ex. 1. The Court will note that they involve much more than \$12,788.00, and include a large item involving responsibility for the constant failure of water wall tubes in the power boiler, as to which the parties were in total disagreement.

This situation appears in the Court's Findings as follows:

“IV. During the time of installation, Waldorf had advanced and expended certain amounts of money for freight, replacement parts and services and had also expended sums in repairing the fan following the failures.” (Tr. I, p. 43)

The Court will further find that Adamek agrees the explanations of Waldorf's offset or backcharge items by Sandberg are correct, in his testimony at pages 23 to 27 of his deposition.

Therefore, the situation is that Sandberg and Adamek lumped together the smaller items as listed in Sandberg's letter, Ex. 1, at \$12,788, items that are uncontested in this record, abandoned the argument over the water wall tubes, and settled their account “for the completion of the project.”



Now, for what consideration can the warranty and product liability be found to have been also included? The record is barren of any sum at all that can be said to be a payment for some \$50,000 of liability, \$29,267 of it not practically in dispute. If the parties had explicitly written that they had agreed upon such a settlement, strange though it might seem, one might accept it, but they have not. Yet, the Court finds this to be the fact against the letters which do most certainly not say so explicitly, against the sworn testimony of the two principals that they did not do so, and against the utter improbability that any such agreement took place.

Reply to this may be that in Adamek's letter, Ex. 2, responding to Ex. 1, he sets forth a different set of items reaching the figure of \$12,788. Mourer had prepared the list, and later he used it to report in detail to B & W in "connection with the accounting records of your (B & W) Company." (Tr. II, p. 33, l. 1-8). This list includes some items referable to the fan failure, and the argument has been that by virtue of the later letter, Ex. 2, the meaning of the earlier letter, Ex. 1, is to be changed and the fan failures included in the deal.

Such a contention does violence to the facts. In reality Ex. 1 and Ex. 2 are the final closing records of the original capital transaction for the

internal accounting records of the parties. This is specifically how Sandberg viewed Adamek's letter, Ex. 2, and why he did not question the differences in the itemization. (Sandberg dpo., p. 40).

To demonstrate this, let us examine one or two of the items in detail. Sandberg included \$1,024.24 as freight on B & W shipments that Waldorf had paid, and obviously this was a correct backcharge. Both Adamek and Mourer admit this. Yet, it is excluded from the list of items in Ex. 2 by B & W. Likewise, Waldorf had expended \$2020 for a crane operator and oiler for the use of B & W's steel erector, C. C. Moore Co., and the validity of this backcharge is not questioned. Yet it, too, is excluded from the list in Ex. 2, whereby room is made in the total to insert \$3078 of items related to the fan failure.

Still more strangely, B & W included in its list an item of \$788 on SC-1387 (last item listed) which was utterly foreign to the whole transaction, as further manifested in the last paragraph of Exhibit 2. We think this conclusively demonstrates that Ex. 2 was an internal accounting record for B & W and not a re-casting of the settlement by including the fan failure claims. There is simply nothing at all to show a recited or agreed consideration in any amount whatever for those claims.

4. *It is incredible that such a transaction would be handled in this manner.*

We are reminded of Mr. Louis Nizer's comments on the rule of probabilities as a guide to the truth, and believe it is applicable here.

In this case we are dealing entirely with educated, experienced, responsible businessmen, all acting in a familiar field, and under no unusual stress which might have affected their normal abilities. We have shown that Sandberg and Adamek had long been corresponding about "settling" their contract balance, and that this was normal procedure apart from any product failure. The fan failures intervened, giving rise to two kinds of liability different from the contract price and legitimate backcharges. An insurance company had become the owner of the later liabilities by paying some \$48,000.00 for the losses they represent.

Normally, the discussion of settlement of those product liabilities would take place between the insurer and the company against whom liability is asserted. If there was a question as to liability or amount, the attorneys for the company would become involved, and the facts carefully ascertained. If a settlement was agreed upon, formal releases of claim would be executed, and the entire transaction documented for business record purposes. The settlement terms and

payment would be clearly described.

Nothing even remotely similar occurred here. The insurer never knew of the matter, else it would not have started this case. No attorneys were consulted by anyone, and no facts were assembled or discussed in any detail whatever. The people representing the defendant were its salesman and its serviceman, whose normal duties did not include settling liability claims. No releases of claim were presented, obtained or sent to anyone, and the letter reporting the transaction to B & W most specifically did *not* say that the fan failure exposures had been settled and closed out (Exhibit X). As we pointed out earlier, there is not a simple clear statement anywhere that the fan failures were settled, and yet it is the most normal and natural thing in the world for that to have been reported in the ordinary course of business.

### CONCLUSION

We believe all our four points, as argued in this brief, mutually support and strengthen each other in the conclusion that this settlement was for the matters related to the “completion of the project” and not to the product liabilities arising so much later. It is really rare to find a situation where there is so much negative evidence, so completely documented, and yet to have the Court

make findings that a given event occurred notwithstanding.

The result of the Court's decision shocks the conscience. By any means or measure one can possibly find in this record, very substantial claims belonging to a third party are held to have been settled and disposed of for no visible consideration or payment of any kind. This is so contrary to justice, to reason, to the sworn words of the principals themselves, that one cannot help concluding the findings are clearly erroneous, and that the cause should be reversed for trial upon the merits of the fan failure claims.

Respectfully submitted,  
GARLINGTON, LOHN & ROBINSON,  
J. C. Garlington,  
Attorneys for Appellants.

#### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

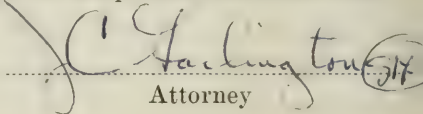
  
Attorney

EXHIBIT 1

PRODUCTS CO.

Missoula, Montana

St. Paul 14, Minnesota

September 7, 1962

Mr. F. A. Adamek

The Babcock &amp; Wilcox Company

Northwestern Bank Building

Minneapolis 2, Minnesota

Dear Frank:

Please refer to our conference at Missoula last week regarding the settlement of our account with you on B&W contracts SC-1387, PR-58, and PFI-2799, and our purchase order 2220.

The following represent all the outstanding invoices on the above purchase order:

Removal of steel for power boiler....	\$ 708.07
---------------------------------------	-----------

Escalation on material for No. 2

Recovery .....	986.00
----------------	--------

5% due on erection of No. 2 Recovery 11,399.75

5% Escalation on No. 2 Recovery....	7,243.73
-------------------------------------	----------

5% on erection of Power Boiler.....	2,592.60
-------------------------------------	----------

Escalation cost on Power Boiler.....	2,645.85
--------------------------------------	----------

Total.....\$25,576.00

The following items are Waldorf-Hoerner out-of-pocket cost for material and services provided for the completion of this project:

Convert 11 soot blowers to motor

drives .....\$ 4,180.00

Removal and replacement of structural steel by Hightower &amp;

Lubrecht for Recovery Boiler .....	2,478.00
------------------------------------	----------

Removal and replacement of steel  
by Hightower & Lubrecht for

Power Boiler .....	708.07
Crane operator and oiler furnished by Hightower & Lubrecht .....	2,020.00
Freight on parts shipped collect.....	1,024.24
Allowance for replacement of I.D. fan expansion joint .....	2,377.69

---

Total Waldorf-Hoerner Net Cost....\$12,788.00

You have refused to consider any allowance for Waldorf-Hoerner labor and supervision; travel expense of the writer and Waldorf, St. Paul, engineering staff, Westinghouse and Clarage Fan Company servicemen's labor and material to restore the No. 2 I.D. fan and drive after two complete failures (the first one occurred within the one year warranty period. We estimate that this amounts to about \$50,000 in round figures; not making any allowance for the loss of production. We could hardly be expected to consider this settlement satisfactory; however, we do not wish to carry on this negotiation any longer; therefore, we reluctantly have approved the payment of \$12,788.00 (this is the balance after deducting the expenses listed above from the outstanding invoices) to bring this account to a close.

You also agreed to settle with C. C. Moore their billing for extra supervision and tool rental in the amount of \$3,236.72—a charge which we feel is not justified since the work involved was actually part of the installation of those boilers.

Yours very truly,  
WALDORF-HOERNER  
PAPER PRODUCTS CO.  
N. H. Sandberg  
President

NHS:jpg  
cc: A. B. Carlson



Stu Nicholson  
Missoula File

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EXHIBIT 2

September 10, 1962

Mr. N. H. Sandberg  
President  
Waldorf-Hoerner Paper Products Company  
Missoula, Montana

Re: Contracts PR-58 & PFI-2799

Dear Mr. Sandberg:

I was pleased to receive your letter of September 7, 1962 relative to the conference held in your Missoula, Montana plant and your check No. 001170 dated September 7, 1962, in the amount of \$12,788.00, which is the amount agreed upon for contracts PR-58 and PFI-2799.

Your letter mentions Contract SC-1387 which is for the steam atomizing venturi equipment for your first Recovery Boiler, PR-44. The two invoices outstanding on this contract were not discussed, nor included in the settlement made at your plant. The following two invoices on SC-1387 are still outstanding:

A-49 January 17, 1961 .....\$10,669.00

A-126 January 30, 1961 .....\$ 800.00

which makes a total for this

contract of .....\$11,469.00

The total of our outstanding invoices on PR-58 and PFI-2799 amounts to \$25,576.00. The amount decided upon to settle those invoices was \$12,788.00, or just half of the above total figure.

In reference to the last paragraph on page 1 of your letter you mentioned that we had refused to consider any allowance for Waldorf-Hoerner labor and supervision, travel expenses for your-

self, and Westinghouse and Clarage Fan servicemen for labor to restore induced draft fan on PR-58. This, I am sure is not altogether correct as we have given an allowance for Clarage service of \$620, balancing expert and instruments \$700, outside machining of fan shaft \$350, rebabbit bearings and machining \$408.

To arrive at the figure we used which is \$12,788.00, the following credit was allowed your concern:

1. Install new door and seal strips on PFI-2799 .....	\$ 600
2. Install new expansion joint above windbox on PFI-2799 .....	672
3. Revise sootblower drives on PR-58.....	4280
4. Install new expansion joint between ID fan and stack on PR-58 .....	900
5. Induced Draft Fan:	
a. Clarage Service .....	1620
b. Balancing expert and instruments.....	700
c. Outside machining of shaft .....	350
d. Rebabbit bearings and machining.....	408
6. Removal and replacement of build- ing steel for erecting PR-58 .....	1762
7. Removal of building steel for erec- tion of PFI-2799 including Crane Operator and Oiler .....	708
8. Stainless steel clad flue from Venturi to elbow SC-1387 .....	788

Along with the above, we took care of the repair and straightening of your induced draft fan shaft in the sum of \$1500. We furnished for the induced draft fan on your Recovery Boiler two new heavier rotors made of Corten material amounting to \$7,165.00.

I have not passed your check on to our New York Treasury Department because of a refer-

ence to Contract SC-1387 in the first paragraph of your letter. This contract was not discussed and was not included in the figure of \$25,576.00 that you have tabulated. I am assuming reference to Contract SC-1387 included in your letter was in error, but will you please confirm so that I may forward your check?

Very truly yours,

THE BABCOCK & WILCOX  
COMPANY

cc: R. Weshoff, NY Treas.

R. V. Mourer, Denver

Chicago S.

F. A. Adamek

---

EXHIBIT 3

WALDORF PAPER PRODUCTS CO.

St. Paul, Minnesota

September 11, 1962

Mr. F. A. Adamek

Babcock & Wilcox Co.

Northwestern Bank Building

Minneapolis 2, Minnesota

Dear Frank:

I have your letter of September 10 and please be advised that the reference to the contract SC-1387 made in our letter of September 7 is in error.

I have approved the invoice covering this contract and Mr. Carlson will issue a check shortly.

Very truly yours,

WALDORF-HOERNER  
PAPER PRODUCTS CO.

(Signed) N. H. Sandberg

N. H. Sandberg

President



Nos. 20799, 20800, 20801

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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MIRRO-DYNAMICS CORPORATION,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

On Appeal from the Judgment of the United States District  
Court for the Southern District of California.

---

## BRIEF FOR APPELLANT.

---

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**FILED**

SEP 20 1966

WM. B. LUCK, CLERK

**FEB 14 1967**



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Nos. 20799, 20800, 20801

IN THE

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UNITED STATES OF AMERICA,

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On Appeal from the Judgment of the United States District  
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## BRIEF FOR APPELLANT.

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### Opinion Below.

The Decision of the District Court is reported at 247 F. Supp. 214. The findings of fact and conclusions of law [R. 277-284] are not officially reported.

### Jurisdiction.

This appeal involves an alleged overpayment of federal income taxes for the fiscal years ended Oct. 31, 1958, 1959 and 1960.

No. 20799

For the 1959 fiscal year the taxpayer paid income taxes of \$249,863.38 plus interest of \$3,274.27 in installments between Jan. 15, 1960 and Nov. 15, 1960. On May 10, 1963, additional income taxes of \$4,426.93

plus interest of \$131.05 were paid. [R. 68-69.] On Sept. 6, 1963 a timely claim for refund for \$200,695.42 was filed with the District Director of Internal Revenue at Los Angeles. [R. 4 *et seq.*] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 2.] Summary Judgment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

No. 20800

For the 1958 fiscal year the taxpayer paid income taxes of \$134,447.23 plus interest of \$759.01 in installments between Jan. 14, 1959 and Nov. 23, 1959. On Aug. 19, 1959, additional income taxes of \$7,043.18 plus interest of \$121.85 were paid. [R. 66-67.] On Nov. 8, 1963 a timely claim for refund of \$37,491.95 was filed with the District Director of Internal Revenue at Los Angeles. [R. 305 *et seq.*] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 303.] Summary judgment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

No. 20801

For the 1960 fiscal year the taxpayer paid income taxes of \$278,027.71 plus interest of \$10,944.11 in installments between May 3, 1961 and Oct. 31, 1961. [R. 70.] On Sept. 6, 1963 a timely claim for refund of \$279,721.96 was filed with the District Director of Internal Revenue at Los Angeles. [R. 336.] The complaint herein was filed May 22, 1964 pursuant to 28 U.S.C. §§ 1340, 1346(a)(1). [R. 334.] Summary judg-

ment was entered Nov. 23, 1965. [R. 286.] Within 60 days and on Jan. 19, 1966 plaintiff filed a notice of appeal. [R. 289.] Jurisdiction is conferred on this Court by 28 U.S.C. §1291.

Each of the aforementioned claims for refund was based on a net operating loss deduction generated by net operating losses sustained in the 1961 and 1962 fiscal years, which plaintiff seeks to carry back to the years here sued upon.

### **Questions Involved.**

1. Whether ordinary, rather than capital, losses resulted from the everyday operation of plaintiff's business of buying and selling securities.
2. Whether the determination as to whether plaintiff's sales of securities were made in the everyday operation of its business created triable issues of material fact requiring denial of the Government's motion for summary judgment.

### **Statute Involved.**

Internal Revenue Code of 1954, §1221(1), 26 U.S.C. §1221(1):

§1221. Capital Asset Defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

### Statement.

In light of the fact that

- (1) judgment was entered in these actions pursuant to the Government's motion for summary judgment,
- (2) there were no agreed facts contained either in a stipulation or pre-trial conference order,
- (3) the only affidavit in support of the motion for summary judgment, by the Assistant United States Attorney defending the case, was insufficient under Fed. R. Civ. P. 56(e), and
- (4) the trial court's decision [R. 235] was in large part premised on facts not contained in pleadings, answers to requests for admissions and interrogatories, or depositions,

it is more than somewhat difficult to present intelligently the operative facts which are in the record.

The taxpayer-Appellant is a California corporation organized in 1947 under the name Pacific Bolt Corporation. [R. 65.] In 1959 the corporate name was changed to Fullview Corp. [R. 65.] Prior to April, 1961 taxpayer was in the business of manufacturing and selling sliding glass doors. [R. 258.] Inventories thereof were maintained by the taxpayer and were priced at cost or market, whichever is lower. [R. 65.] In the spring of 1961 the taxpayer sold substantially all of its assets which related to its former business of manufacturing sliding glass doors, for a cash consideration approximating one million dollars, discontinued the sliding door business, its then only business, changed its name to Mirro-Dynamics Corporation, and moved its offices

to 961 N. La Cienega Blvd., Los Angeles, Calif. [R. 258.]

Pursuant to resolution of the board of directors, taxpayer opened accounts with brokers, in order to go into the business of buying and selling stocks and other securities. At the same time taxpayer maintained an office at H. Hentz & Co., in Beverly Hills, a New York Stock exchange member firm. [R. 258.] The taxpayer's two principal officers devoted their entire time daily from 7 a.m. to the corporation's business of buying and selling securities, which was its only business. At various times the taxpayer made attempts to acquire large blocks of stock with a view to effecting public distribution thereof and with a view to maintaining a market therein. [R. 258.]

During its fiscal year ended Oct. 31, 1961 the taxpayer purchased a total of \$3,023,313.91 worth of securities which were sold for \$3,039,658.41 in hundreds of different transactions. [R. 7 *et seq.*] During its fiscal year ended Oct. 31, 1962 the taxpayer purchased and sold in the course of its business thousands of shares of stock in several hundred different transactions. Inventories were maintained of all of such securities. During that year the taxpayer sold securities with a cost of \$4,944,582.49 for \$4,038,721.02. [R. 175 *et seq.*; 258.]

During 1961-1962 taxpayer was actively, directly, and continuously engaged in the business of buying and selling securities, for cash and on margin, dealing in puts and calls, and selling short. [R. 258.] Not all of taxpayer's transactions were effected through brokers. At no time did taxpayer purchase or sell any securities with an investment motive. At various times taxpayer's

officers dealt directly with principals. The taxpayer had no other business activities after April, 1961. [R. 259.]

The claims for refund filed for 1959 and 1960 are primarily premised on net operating loss carrybacks of the \$905,861.47 loss generated in the 1962 year in the securities' business and a deduction for federal transfer taxes of \$1,592.60. Other deductions claimed are not here in issue as they were conceded by the defendant, and gave rise to the affirmative judgments in the plaintiff's favor for the 1958 and 1959 years. [R. 286-287.]

During an audit by the Internal Revenue Service of plaintiff's affairs, plaintiff was advised that since the inventories of sliding doors had been priced at cost or market, whichever is lower, it was an improper change of inventory pricing to price inventories of securities at cost. [R. 259.] In order to reflect the pricing of its closing inventory of securities at cost or market, whichever is lower, the operating loss for the 1961 year was increased, thereby generating an additional net operating loss deduction for 1958. [R. 305 *et seq.*]

Without any finding of fact as to what plaintiff's business was during 1961-1962, other than the subsidiary finding that plaintiff purchased and sold securities solely for its own account [R. 282, Par. 14], the trial court granted the Government's motion for summary judgment on the basis that all of plaintiff's securities were not inventory and were capital assets [R. 283], resulting in a capital loss of \$905,861.47 which cannot be carried back.

For the 1958 year, plaintiff had judgment for \$4,312.08 based on a conceded dividends received deduc-



tion for 1961 in the sum of \$8,292.46. [R. 286, 281.] For the 1959 year, plaintiff had judgment for \$7,518.07 based on conceded dividends received and state transfer tax deductions in the total sum of \$14,461.83. [R. 287, 281.] For the 1960 year, plaintiff took nothing. [R. 287.]

### **Specification of Errors.**

1. The District Court erred in granting defendant's motion for summary judgment.
2. The District Court erred in failing to find and conclude that there were genuine issues of material fact to be tried.
3. The District Court erred in failing to make a finding or conclusion as to whether there were or were not any genuine issues of material fact to be tried.
4. The District Court erred in considering the Affidavit of Arthur M. Greenwald in determining the motion for summary judgment.
5. The District Court erred in considering anything but the pleadings in making its findings of fact.
6. The District Court erred in concluding that the securities bought and sold were capital assets.
7. The District Court erred in concluding that the loss from its securities' business in the sum of \$905,-861.47 was a capital loss.
8. The District Court erred in failing to find that plaintiff did inventory its securities.
9. The District Court erred in not rendering judgment as prayed for in the amended complaints.
10. The District Court erred in concluding that the scope of plaintiff's business was not a question of fact.



### Summary of Argument.

In 1962 the plaintiff corporation's everyday operation of its business consisted of buying and selling securities. If the losses which plaintiff incurred in this everyday operation are characterized as ordinary losses, they may be carried back under Internal Revenue Code §172 against the profits which plaintiff made in its everyday operations of prior years. If, however, these losses, which amounted to almost a million dollars, are characterized as capital losses, the whittling away to zero of this fortune, the acquisition of which had only so recently resulted in the taxes which are here sought to be recovered, would by a quirk of language be totally ignored.

As recently as March, 1966, the Supreme Court has enunciated that the purpose of Internal Revenue Code, §1221(1), which excludes from the definition of capital assets "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business", is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand and the "realization of appreciation in value accrued over a substantial period of time" on the other. *Malat v. Riddell*, 383 U.S. 569, 572 (1966). The securities involved in the case at bar were each bought and sold by the taxpayer within only a few months, clearly not a "substantial period of time", so that the transactions which were in fact made in the course of the taxpayer's everyday operation, must be classified in the only remaining portion of the Supreme Court's dichotomy, as "profits and losses arising from the everyday operation of a business".

Although the exclusion in §1221(1) provides that the property must be held primarily for sale to customers, the judicial interpretation thereof especially by this Court and that espoused by the Solicitor General before the Supreme Court in *Malat v. Riddell*, 383 U.S. 569 (1966), is that if one is in the business, any sale is to “a customer.”

The court below made a conclusion of law that “The plaintiff is not a dealer in securities, *Schafer v. Helvering*, 299 U.S. 171 (1936); Commissioner’s Regulations 1.471.5.” This conclusion was not based upon any finding of fact. The statement in the court’s prior memorandum that “The plaintiff here is not a dealer, for a dealer is one who, as a merchant, buys and sells securities to customers for the profit thereon. *Schafer v. Helvering*, 299 U.S. 171 (1936)” must be disregarded, under the well settled rule that deficiencies in formal findings cannot be filled in by reference to the memorandum decision. In any event, both the *Schafer* case and the regulation cited by the court were concerned with whether the taxpayer would be considered a dealer for the purpose of deciding whether he would be allowed to inventory his securities, turning on whether the taxpayer was a merchant in securities. This Court has held that whether or not one is a dealer for inventory purposes within this definition is not decisive for the purpose of determining whether ordinary income or capital gains are generated by the taxpayer’s activities.

§1221, with which we are here concerned, does not define “dealer” and in these actions the tax affect of the taxpayer’s pricing of its securities inventory is not materially significant. Whether the taxpayer is a

dealer for inventory purposes is, therefore, immaterial to whether the taxpayer suffered ordinary losses from its business activities. Thus, even if the lower court's conclusion of law that plaintiff was not a dealer for inventory purposes had been based on proper findings and evidence, such a conclusion would be immaterial to the determination of this case.

The lower court's judgment was pursuant to the Government's motion for summary judgment, based only on the pleadings, affidavit of Arthur M. Greenwald, the Assistant United States Attorney handling these actions, and a supporting memorandum. This affidavit was not based on personal knowledge, did not satisfy the conditions of Fed. R. Civ. P. 56(e), and should not have been considered by the court. If this affidavit had been eliminated from the lower court's consideration, then the court would have had before it only the complaints and answers from which to determine whether there were genuine triable issues of material fact. Since a determination of the extent of the taxpayer's activities and its intent and motive in buying and selling securities is essential to such a decision, there is no doubt that there were genuine triable issues of material fact, compelling denial of the motion for summary judgment even if the affidavit had been sufficient. The lower court should have merely determined that there were issues of fact rather than purporting to decide those issues based on the insufficient record before it.

I.

**The Affidavit of the Assistant United States Attorney in Support of His Motion for Summary Judgment Was Insufficient Under Fed. R. Civ. P. 56(e) and Should Not Have Been Considered by the Lower Court.**

The United States' motion for summary judgment is based on "the pleadings and the affidavit and memorandum in support thereof." [R. 187.] The affidavit referred to is that of Arthur M. Greenwald, the Assistant United States Attorney who represented the government in the lower court in the defense of this case. [R. 188.] The affidavit, which has no exhibits or papers attached [R. 188-191], states, in substance:

Par. 2: Mr. Greenwald is a certified public accountant;

Par. 3: In November 1964, he reviewed certain of the plaintiff's accounting records and papers;

Par. 4: In 1961, plaintiff sold substantially all the assets which related to its former business of manufacturing sliding glass doors and used the cash it received to buy other assets in the form of marketable securities;

Par. 5: Plaintiff maintained a general ledger account in which purchases and sales of securities were summarized;

Par. 6: Plaintiff maintained a liability account reflecting money owed for the purchase of marketable securities;

Par. 7: Mr. Greenwald reviewed plaintiff's income tax returns for the 1961 and 1962 fiscal years. He set forth the total of gains and losses from securities transactions reported therein;

Par. 8: The schedules attached to plaintiff's tax returns are described, but it is not stated whether this description is the conclusion of Mr. Greenwald or someone else or how he came to the conclusion as to the origin of the figures. Was it done by Mr. Greenwald, or is it even ranker hearsay because it was done by someone else?

Par. 9: This states that certain schedules were compared to certain working papers and confirmation slips and account statements. Again, it does not say who made the comparison or who "established" the other allegations of this Paragraph.

Even if the affidavit complied with Fed. R. Civ. P. 56(e), it would not establish sufficient facts to support a summary judgment. The basic issue is as to the taxpayer's intent, which is a factual matter to be tried by the Court, and this affidavit sheds no light on what such intent was.

In any event, the lower court should not have considered this affidavit in ruling on the motion for summary judgment, as it does not comply with Fed. R. Civ. P. 56(e).

Rule 56(e) provides in pertinent part:

"(e) *Form of Affidavits; Further Testimony; Defense Required.* Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. . . ."

This Court has held that all references to papers which were neither attached to nor served with an affidavit should be disregarded. *State of Washington v. Maricopa County*, 143 F. 2d 871, 872 (9th Cir. 1944). Since Greenwald's affidavit refers to numerous papers and documents which the lower court did not have before it, the affidavit was insufficient and should not have been considered in determining the motion for summary judgment.

In addition, the Assistant United States Attorney defending the action could have no personal knowledge of the operative facts. His affidavit lays no foundation for his competency and his testimony would not be admissible at the trial. *Hoston v. J. R. Watkins Co.*, 300 F. 2d 869, 870 (9th Cir. 1962); *Paramount Pest Control Service v. U.S.*, 304 F. 2d 115, 116 (9th Cir. 1962); *Durovic v. Palmer*, 342 F. 2d 634, 637 (7th Cir. 1965); *Fowler v. So. Bell Tel. Co.*, 343 F. 2d 150, 154 (5th Cir. 1965); *Willetts v. General Telephone Directory Co.*, 38 F.R.D. 406, 409 (S.D. N.Y. 1965); *Young v. Atlantic Mut. Ins. Co.*, 38 F.R.D. 416, 418 (E.D. Pa. 1965). Rule 56(e) is quite explicit in requiring affidavits to be made on "personal knowledge" and has resulted in rejection of an affidavit of an assistant U.S. attorney based "upon knowledge and information gained from examination of the files of the Internal Revenue Service." *Wellhouse v. Tomlinson*, 197 F. Supp. 739, fn. 2 (S.D. Fla. 1961).

Greenwald's incompetency to testify as a witness is further demonstrated by the fact that it would be clearly improper and unethical for defense counsel to take the witness stand and attempt to testify as to his opinions and hearsay conclusions, based on his own investigation.



Indubitably, it is undesirable to permit counsel for one of the litigants to attempt to inject his interpretation of the facts where he has no personal knowledge thereof.

In view of the fact that Greenwald is incompetent to testify as a witness and has no personal knowledge of the facts and the fact that the affidavit is deficient under Rule 56(e) in that no copies of the papers referred to were supplied, the lower court should not have considered his affidavit.

Without this affidavit, the motion for summary judgment is premised only on "the pleadings ~~and the affidavit~~, and memorandum in support thereof." [R. 187.] It must, therefore, be considered a motion for judgment on the pleadings. *Mercantile Nat. Bank v. Franklin Life Ins. Co.*, 248 F. 2d 57, 59 (5th Cir. 1957).

A motion for judgment on the pleadings "must be denied 'unless it appears to a certainty' that plaintiffs are 'entitled to no relief under any state of facts which could be proved in support of the claim'." *Brown v. Bullock*, 194 F. Supp. 207, 247 (S.D. N.Y. 1961), *aff'd* 294 F. 2d 415 (2nd Cir. 1961). Such a criterion is not appreciably different from that used in determining a motion to dismiss on the ground that no claim upon which relief may be granted has been stated. The facts well pleaded in the complaint and inferences therefrom are deemed admitted for the purposes of a motion for judgment on the pleadings. *Brown v. Bullock*, 194 F. Supp. at 210. A reading of the amended complaints together with exhibits [R. 85-87, 4-21; 326-328, 305-322; 357-359, 336-353], in light of the applicable substantive law hereinafter discussed, compels the conclusion that such a motion should properly have been denied.



The policy of the courts is to dispose of law suits on their merits whenever possible rather than on motions for summary judgment or judgments on the pleadings. *Tuolumne Gold Dredging Corp. v. W. W. Johnson Co.*, 61 F. Supp. 62, 63 (N.D. Cal. 1945).

## II.

### **In Light of Supreme Court Decisions Requiring Ordinary Income Treatment of the Everyday Operations of a Business, Summary Disposition of These Suits for Refund Is Error.**

- (A) Because There Are Genuine Triable Issues of Material Fact;**
- (B) Because to Decide These Cases the Trier of Fact Must Draw Inferences of Fact to Determine the Taxpayer's Subjective Intent and Motives.**

A jury trial was timely demanded in each of the instant actions. [R. 3, 304, 335.] In order for this Court to determine whether the plaintiff should have been afforded a jury trial instead of summarily being denied its day in court, a review of the statutory provisions as interpreted by the Supreme Court of the United States is essential.

In general, the Internal Revenue Code imposes an ordinary income tax on the profits derived from carrying on a trade or business, regardless of whether the regular business income is compensation for services, rental income, or proceeds from the sale of property. However, the Code generally gives special treatment to gains derived from sales of property outside the scope of normal business operations, on the theory that they are usually the result of a long-term passive investment.

If a taxpayer regularly purchases items for resale, it is clear that its business profits derived from sales of such items will be taxed as ordinary income. "Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss," and that only those transactions "which are not the normal source of business income" would be taxed as capital gain. *Corn Products Co. v. Com'r*, 350 U.S. 46, 52, *reh. denied*, 350 U.S. 943.

The term "capital gain" has been used in the law for so long that we viscerally feel that the statutory definition thereof provides a readily ascertainable yardstick for determining the applicability and scope thereof. The Code defines "capital gain" in terms of the "sale or exchange of a capital asset." Internal Revenue Code §1222. Congress in §1221(1) phrased the definition of "capital asset" to include all property, excluding therefrom among other things:

"stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of a taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . .".

Despite these deceptively simple words by which Congress has attempted to exclude from "capital gain" all of those profits which it regards as the everyday profits of the business world, the Supreme Court has repeatedly been called upon to delineate the ambit of these provisions.

The Supreme Court has made it clear that ordinary business profits cannot be converted to, and taxed as, capital gains. If "necessary to effectuate the basic con-

gressional purpose, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." In no event may "the capital-asset provision . . . be so broadly applied as to defeat rather than further the purpose of Congress." *Corn Products Co. v. Com'r*, *supra*, 350 U.S. at 52. Whenever possible the Court has read the statutory exclusions broadly, so as to exclude "profits . . . arising from the everyday operation of a business." Even when this was not possible the Court has denied capital gain to such profits by narrowly reading the definition of a capital asset. See *Malat v. Riddell*, 383 U.S. 569 (1966); *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965); *Com'r v. Gillette Motor Co.*, 364 U.S. 130 (1960); *Com'r v. P. G. Lake, Inc.*, 356 U.S. 260 (1958); *Corn Products Co. v. U.S.*, 350 U.S. 46 (1955); *Watson v. Com'r*, 345 U.S. 544 (1953); *Burnet v. Harmel*, 287 U.S. 103 (1932); *Hort v. Com'r*, 313 U.S. 28 (1941).

In the *Midland-Ross* case, the Supreme Court held (381 U.S. at 56) that original issue discount measured by the gain on sale of non-interest bearing promissory notes was taxable as ordinary income and not capital gain. Although such original issue discount becomes property when the obligation falls due,

" 'not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year.' *Commissioner v. Gillette Motor Co.*, 364 U.S. 130, 134."

The recent *Malat* and *Clay Brown* decisions reiterated the foregoing concept. (*Malat*, 383 U.S. at 572; *Com'r v. Brown*, 380 U.S. 563, 572.)

Concededly none of these Supreme Court decisions is on all fours with the instant actions. In the *Corn Products* case, *supra*, the Court held that where a taxpayer purchased and sold corn futures as an integral part of its manufacturing business to protect itself against a rise in the price of corn, gains and losses from such sales gave rise to ordinary income and ordinary losses. If a sale in the furtherance of a business and as an integral part of the business yields ordinary income, *a fortiori* any of the multitudinous sales constituting the business itself must yield ordinary income. See, *Hallcraft Homes, Inc. v. Com'r*, 336 F. 2d 701, 705 (9th Cir. 1964). In *Gillette Motor, supra*, the Court held that "capital asset" does not include compensation awarded a taxpayer as representing the fair rental value of its facilities during the period of their operation under government control. The amount of the proceeds of the sale of an orange grove attributable to the value of an unmaturing annual crop was treated as ordinary income in *Watson v. Com'r, supra*. Oil payment rights in *Com'r v. P. G. Lake, Inc., supra*, and payments in lieu of rent on cancellation of an unexpired lease in *Hort v. Com'r, supra*, were similarly held to be ordinary income.

Although each of the foregoing decisions is factually distinguishable from the actions at bar, the trend of the Supreme Court's pronouncements is patently in the direction here urged, viz. the everyday operations of a business enterprise yield ordinary income and loss. Both the majority opinion by Justice White and the dissent by Justice Goldberg in the *Brown* case, *supra*, were prem-

ised on the statutory provisions not “being designed to allow capital gain treatment for the recurrent receipt of commercial or business income.” 380 U.S. at 572, 584.

The application of these criteria and the ambit of the capital gains provisions is a question of fact. This Court has repeatedly so held. *Austin v. Com’r*, 263 F. 2d 460, 461 (9th Cir. 1959). In *Wineberg v. Com’r*, 326 F. 2d 157, 160 (9th Cir. 1963), this Court said:

“The Tax Court held that during the taxable years in question the taxpayer was engaged in the trade or business of selling timber. We agree with the Tax Court that what constitutes a trade or business is a question of fact.”

In order for the trier of fact to resolve the instant controversy, there must be a determination of the following material issues of fact [R. 229]:

- (1) what was the everyday operation of plaintiff’s business from and after April, 1961?
- (2) what activities did plaintiff engage in in the pursuit of its securities’ business?
- (3) whether plaintiff maintained inventories of securities?

In this case, the parties have never reached a stipulation of facts, nor has the lower court entered a Pre-Trial Conference Order pursuant to Fed. R. Civ. P. 16 and Local Rule 9 of the Rules for the Southern District of California. Although the parties did attempt to achieve such an objective pursuant to these rules, the Minute Order of April, 1965 [R. 168] reflects the lower court’s frustration in that respect, and the parties were ordered to proceed to trial on September 21, 1965 without a pre-trial order or stipu-

lation of facts. Prior to the hearing on April 28, 1965 and pursuant to the court's order, the parties had filed their versions of all the issues of fact to be incorporated into a Pre-Trial Conference Order.

The plaintiff filed its "Proposed Amendment to Proposed Pre-trial Conference Order re Issues of Fact" on April 21, 1965. [R. 157A.] It reflects as issues four facts to which the defendant would not agree, but which would not be contested by evidence to the contrary. [R. 157B.] In addition, twenty other issues of fact on which no agreement could be reached with the defendant were set forth. [R. 157B-C.]

On April 22, 1965 the Government filed its "Proposed Issues of Fact" setting forth twenty-nine issues of fact to be litigated. [R. 158-165.]

None of these issues was resolved at the hearing thereon on April 28, 1965, and the actions were ordered to trial without any agreement as to facts or issues. [R. 168.] Between that time and the end of June 1965, no stipulations were reached. [R. 229.] In the interim the defendant filed its motion for summary judgment on June 17, 1965 [R. 186], based *only* on the pleadings, the Greenwald affidavit, and the supporting memorandum. The complaints and answers alone raise sufficient issues to justify denial of the motion, and these issues would not be resolved by the Greenwald affidavit even if consideration of that affidavit by the court had been proper. Apparently, in denying plaintiff's Motion to Vacate the Decision [R. 275-6], the court also improperly considered the requests for admissions and interrogatories and answers thereto filed by both parties, in addition to the Greenwald affidavit in support thereof and the Wood-



man affidavit [R. 257-9] in opposition thereto, as well as the depositions on file.

Since the motion for summary judgment was based only on the pleadings, the Greenwald affidavit, and supporting memorandum, since the Greenwald affidavit was deficient under Rule 56(e), and since the depositions, the requests for admissions and interrogatories and answers thereto are not "pleadings", no consideration should have been given to these documents upon the motion. It is submitted that the court should have ruled on the motion giving consideration only to the pleadings (the complaints and answers) and the memorandum, and, based thereon, denied the motion.

Assuming, for the sake of argument only, that the court was justified in considering the other papers which it apparently considered, it is submitted that the court erred both in fact and law in reaching its decision. The Decision erroneously assumes that all items claimed in the pleadings have been resolved except [R. 236] :

1. whether the 1962 loss of \$905,861.47 was an ordinary business loss and not a capital loss;
2. whether the securities on hand on October 31, 1961 were a form of inventory;
3. whether the federal stock transfer tax is a business expense.

There is no justification whatsoever for such an assumption nor is there anything in the record to support it.

As these three actions are for refund of income taxes paid, the burden is on the plaintiff to prove its total income and expenses to sustain the overpayment of taxes urged. As the defendant has urged in *Roybark v. U.S.*,



218 F. 2d 164, 166 (9th Cir. 1954) and in many other refund suits:

“... an action to recover taxes is in the nature of an action for money had and received, and the taxpayer must show the tax was overpaid. The principle relied on by the Government appears to be settled law.”

There is nothing before the Court by which it can determine whether the amounts of the summary judgments are correct or not. In an attempt to eliminate any issue with respect to the income and expenses aside from dealings in securities for the loss years and the income and expenses aside from any net operating loss deduction for the years sued upon, plaintiff requested defendant to admit:

(1) that for the 1958 fiscal year “The correct net taxable income for said year was \$282,673.87 before deducting any net operating loss deduction.” [R. 55.] Such a request serves to narrow the issue to one of determining the amount of any carry-backs and carryovers from other years to said year in order to arrive at the net operating loss deduction for 1958. Internal Revenue Code, §172(a). Defendant would only admit [R. 67] that “the correct net taxable income for fiscal year ended October 31, 1958 was \$282,673.87, before considering the net operating loss carry-back of \$186,229.90 generated from fiscal year ended October 31, 1961.”

(2) that for the 1959 fiscal year “The correct net taxable income for said year was \$499,596.76 before deducting any net operating loss deduction.” [R. 56.] Defendant would only admit [R. 69] that “the correct net taxable income for fiscal year ended October 31, 1959 was \$499,596.76 before considering the net operating

loss carry back of \$109,615.78 generated from fiscal year ended October 31, 1962.” This again is an illusory admission and does not relieve plaintiff of proving all its deductions.

(3) that for the 1960 fiscal year “The correct net taxable income for said year was \$545,245.60 before deducting any net operating loss deduction.” [R. 56.] This was denied by defendant. [R. 71.]

(4) that for the 1961 fiscal year “The operating loss for said year was \$194,522.36 before considering the additional net losses from dealings in securities.” [R. 57.] This was denied by defendant. [R. 91.]

(5) that for the 1962 fiscal year “The operating loss for said year was \$139,609.21 before considering the additional net losses from dealings in securities.” [R. 57-8.] This was denied by defendant. [R. 92.]

Thus, neither Greenwald’s affidavit nor any admission or answer to interrogatory supplies the Court with the information necessary to determine the correct amount of the income and deductions from which the correct tax can be computed. This problem was first brought to the lower court’s attention in the Plaintiff’s Statement of Genuine Issues [R. 229, line 17.] There is no doubt that if the defendant would not admit the foregoing, it does constitute a triable issue of fact, necessary for the computation of any overpayment of tax under the *Roybark* decision. As the lower court pointed out at 164 F. Supp. 759, 762 (S.D. Cal. 1952):

“Not only must the plaintiff show that the Commissioner was wrong, but he must go further and establish the essential facts from which a correct determination of his tax liability can be made.

Lewis v. Reynolds, 284 U.S. 281, 283, 52 S.Ct. 145, 76 L.Ed. 293; Forbes v. Hassett, 1 Cir., 124 F.2d 925, 928; Harvey v. Early, 4 Cir., 189 F.2d 169; Swift Mfg. Co. v. U. S., 12 F.Supp. 453, 456, 81 Ct.Cl. 932. The taxpayer must show that he has overpaid his tax and that involves a redetermination of his entire tax liability. Globe Gazette Printing Co. v. U. S., 13 F.Supp. 422, 425, 82 Ct.Cl. 586. He must show the exact amount to which he is entitled. Helvering v. Taylor, 293 U.S. 507, 514, 55 S.Ct. 287, 79 L.Ed. 623.”

For the 1961 fiscal year, the defendant raised an issue which would affect the amount of the net operating loss deduction for the 1958 fiscal year. In its Answer to the First Amended Complaint in action 64-693 [R. 329], the defendant urged as an affirmative defense [R. 330-1] that the 1961 corporate gross income was understated by \$88,564 as the result of failing to report the entire consideration received on the sale of the sliding glass door business. The defendant was requested to admit [R. 56] that “In April, 1961 the taxpayer sold all of its assets to Cal-Tech Systems and received in cash the sum of \$1,041,271.00 which it reported in its tax return.” Defendant denied that this was the sum received. [R. 71.] In plaintiff’s Statement of Genuine Issues, plaintiff posed as a triable issue of fact: “whether plaintiff reported the correct proceeds from the sale of its sliding door business in April, 1961?” [R. 229.] Only after the Court on August 30, 1965 rendered decision in defendant’s favor did defendant in its Opposition to the Motion to Vacate the Decision then “acknowledge” that this amount constitutes the correct proceeds from the sale. [R. 256H.]

Similarly with respect to plaintiff's genuine issues 7 and 8 [R. 229], only after the court's Decision, did defendant decide not to contest these issues as set forth in its Memorandum in Opposition to the Motion to Vacate the Decision. [R. 256G.] Prior to the filing of this Memorandum on September 9, 1965 [R. 256A] neither the plaintiff nor the lower court could have known that the defendant would change its position.

this, no stipulation could be reached in this respect, and even at the time the court's decision on the motion for summary judgment was filed, these were genuine triable issues of fact among others hereinafter discussed in addition to those posed by the lower court. [R. 236.] It is submitted that the motion for summary judgment should have been denied based on the foregoing in light of the judicial construction of Fed. R. Civ. P. 56.

"On appeal from an order granting a defendant's motion for summary judgment the circuit court of appeals must give the plaintiff the benefit of every doubt." *Sprague v. Vogt*, 150 F. 2d 795, 800 (8th Cir. 1945).

This Court, in *Griffith v. Utah Power & Light Co.*, 226 F. 2d 661, 669 (9th Cir. 1955), concisely set forth the criteria which a trial court should use where there has been a demand for jury trial:

"The federal Constitution gives a right of jury trial in a contested issue in a law action. This right is positive and should not be whittled away by decision of contested issues by the judge at hearings in camera before trial. The summary judgment rule does not confer this power even in a non-jury case. The remedy can be invoked only when complete absence of genuine fact issue appears on the face of the record. Resort to summary judgment proce-

cedure is futile where there is any doubt as to whether there is a fact issue. All doubts upon the point must be resolved against the moving party. This Rule, on account of these limitations, was not intended to be used as a substitute for a regular trial of cases where 'there are disputed issues of fact upon which the outcome of the litigation depends.' This procedure is not, and of right ought not to be, a substitute for a trial by jury or judge."

As in *New and Used Auto Sales v. Hansen*, 245 F. 2d 951, 952 (9th Cir. 1957),

"The trial court here attempted to use summary judgment procedure to supply the place of pleadings and of trial. The efficiency of this device to eliminate from congested trial dockets cases in which there is no substantial dispute of fact is not denied, nor could it be. But this circumstance cannot be used as an excuse to hear and determine causes which are not before the court by pleading or otherwise."

In light of the numerous hearings reflected in the docket entries, it is not surprising that the lower court observed that more time has been wasted in these matters on preliminary motions, hearings, attempts at pre-trial, etc. than it would have taken to try them. [R. 264.] However true this may be, it constitutes no reason for a trial by affidavit.

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"TRIAL BY AFFIDAVIT IS NO SUBSTITUTE FOR TRIAL BY JURY WHICH SO LONG HAS BEEN THE HALLMARK OF 'EVEN HANDED JUSTICE'" *Poller v. Col. Broad. System*, 368 U.S. 464, 473 (1962).

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“Rule 56(c), Fed. R. Civ. P., 28 U.S.C.A., provides that a motion for summary judgment should be granted ‘if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.’ Standards for the application of this rule have been thoroughly developed by this court. (citations) While it is the duty of the trial court to grant a motion for summary judgment in an appropriate case, the relief contemplated by Rule 56 is drastic and should be applied with caution to the end that the litigants will have a trial on bona fide factual disputes. Under the rule no margin exists for the disposition of factual issues, nad it does not serve as a substitute for a trial of the case nor require the parties to dispose of litigation through the use of affidavits. The pleadings are to be construed liberally in favor of the party against whom the motion is made, but the court may pierce the pleadings, and determine from the depositions, admissions and affidavits, if any, in the record whether material issues of fact actually exist. If, after such scrutiny, any issue as to a material fact dispositive of right or duty remains the case is not ripe for disposition by summary judgment, and the parties are entitled to a trial.” *Bushman Const. Co. v. Conner*, 307 F. 2d 888, 892 (10th Cir. 1962).

“. . . it is also a maxim that the court, on a motion for summary judgment, cannot *try* issues of fact but can only determine whether there *are* issues of fact to be tried; and, once having deter-



mined this affirmatively must leave those issues for determination at a trial." *Empire Electronics Co., Inc. v. U.S.A.*, 311 F. 2d 175, 179 (2d Cir. 1962).

"And all reasonable doubts touching the existence of a genuine issue as to a material fact must be resolved against the party moving for summary judgment." *Traylor v. Black, Sivalls & Bryson, Inc.*, 189 F. 2d 213, 216 (8th Cir. 1951).

In *Knapp v. Kinsey*, 249 F. 2d 797, 801 (6th Cir. 1957), the court pointed out that

"In *Begnaud v. White*, 6 Cir., 170 F. 2d 323, 327, we said, 'The authorities indicate that the trial judge should be slow in passing upon a motion for summary judgment which would deprive a party of his right to a trial by jury where there is a reasonable indication that a material fact is in dispute,' citing *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620. In *Lloyd v. United Liquor Corp.*, 6 Cir., 203 F. 2d 789, 793, we quoted with approval from the opinion in *Doehler Metal Furniture Co. v. United States*, 2 Cir., 149 F.2d 130, 135, as follows, 'We take this occasion to suggest that trial judges should exercise great care in granting motions for summary judgment. \* \* \* Such a judgment, wisely used, is a praiseworthy and time-saving device. But, although prompt despatch (sic.) of judicial business is a virtue, it is neither the sole nor the primary purpose for which courts have been established. Denial of a trial on disputed facts is worse than the delay.' Other cases in which we held that summary judgment proceedings did not afford the losing party an adequate opportunity to develop



the facts and should not have been used are *Estepp v. Norfolk & Western Railway Co.*, 6 Cir., 192 F. 2d 889; *Bellak v. United Home Life Insurance Co.*, 6 Cir., 211 F.2d 280, 283, and *Hoy v. Progress Pattern Co.*, 6 Cir., 217 F.2d 701, 704.”

In *Kennedy v. Silas Mason Co.*, 334 U.S. 249, 256 (1947), the Supreme Court pointed out that

“summary procedures, however salutary where issues are clear-cut and simple, present a treacherous record for deciding issues of far-flung import, on which this Court should draw inferences with caution from complicated courses of legislation, contracting and practice.

“We consider it the part of good judicial administration to withhold decision to the ultimate questions involved in this case until this or another record shall present a more solid basis of findings based on litigation or on a comprehensive statement of agreed facts.”

Based on what the lower court had before it in determining the motion for summary judgment, there is no doubt that inferences were drawn despite the paucity of facts before the court. It is submitted that there was nothing before the lower court bearing on the plaintiff's intent in the purchase and sale of securities. In *Poller v. Columbia Broadcasting System*, *supra*, 368 U.S. at 473, the Supreme Court concluded that:

“We believe that summary procedures should be used sparingly \* \* \* where motive and intent play leading roles, the proof is largely in the hands of

the alleged conspirators, and hostile witnesses thicken the plot. It is only when the witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised.”

In *Cross v. United States*, 336 F. 2d 431, 433 (2d Cir. 1964), the like principle was aptly expressed as follows:

“Summary judgment is particularly inappropriate where ‘the inferences which the parties seek to have drawn deal with questions of motive, intent and subjective feelings and reactions.’ *Empire Electronics Co. v. United States*, 311 F.2d 175, 180 (2d Cir. 1962); See *Alabama Great So. R.R. v. Louisville & Nashville R.R.*, 224 F. 2d 1, 5 (5th Cir. 1955); *Subin v. Goldsmith*, 224 F. 2d 753, 758 (2d Cir. 1955).’ ‘A judge may not, on a motion for summary judgment, draw fact inferences. \* \* \* Such inferences may be drawn only on a trial.’ *Bragen v. Hudson County News Co.*, 278 F. 2d 615, 618 (3d Cir. 1960).”

Even where the underlying physical data are not in dispute, the court cannot, on motion for summary judgment, determine the intention of the parties concerning transfer of title. *Empire Electronics Co. v. United States*, 311 F. 2d 175, 178 (2d Cir. 1962). The inferences of fact to be drawn from such evidentiary facts are disputed and present a genuine issue as to a material fact. *Ibid.*

“And the courts have often held that genuine issues of material fact exist, within the meaning of

the summary judgment rule, where, as here, reasonable men differ about the inferences to be drawn from undisputed basic facts.”

*Tanaka v. Im. & Nat. Serv.*, 346 F. 2d 438, 447 (2d Cir. 1965);

*Buren v. Schein*, 32 F.R.D. 218, 220 (E.D. N.Y. 1963) [citing *Empire Electronics*];

*Winter Park Tel. Co. v. So. Bell Tel & Tel. Co.*, 181 F. 2d 341 (5th Cir. 1950).

The plaintiff here urged to the lower court as genuine issues [R. 229]:

“3. what was plaintiff’s intent in the acquisition and disposition of securities?

4. what plaintiff’s everyday operation of its business was?

5. what activities plaintiff engaged in in pursuit of its securities business?”

This Statement of Genuine Issues [R. 229] was filed pursuant to Local Rule 3(d)(2) for the Southern District of California which provides in pertinent part:

“Any party opposing the motion may, not later than three days prior to the hearing, serve and file a concise ‘statement of genuine issues’ setting forth all material facts as to which it is contended there exists a genuine issue necessary to be litigated.”

The record is almost barren of anything bearing on these issues and the only findings of fact remotely touching thereon are Paragraphs 14, 15 and 16. [R. 282.] Even these findings are not responsive to the foregoing issues and aside from finding that plaintiff had a substantial number of stock transactions with several brokers, they are otherwise phrased in the negative.

There is nothing to indicate what the plaintiff did do, or to indicate what the plaintiff's everyday operation of its business was.

To further show that there was nothing before the court by which it could determine plaintiff's intent, plaintiff's president Gerald Woodman stated in his affidavit [R. 258] that

"6. The taxpayer at various times made attempts to acquire large blocks of stock with a view to effecting public distribution thereof and with a view to maintaining a market therein.

7. During its 1961 fiscal year the taxpayer purchased \$3,023,313.91 worth of securities which were sold for \$3,039,658.41 in hundreds of different transactions. During its 1962 fiscal year the taxpayer purchased and sold in the course of its business thousands of shares of stock in several hundred different transactions. Inventories were maintained of all of such securities. During that year the taxpayer sold securities with a cost of \$4,944,582.49 for \$4,038,721.02.

8. During 1961-62 taxpayer was actively, directly and continuously engaged in the business of buying and selling securities, for cash and on margin, dealing in puts and calls, and selling short. Not all of taxpayer's transactions were effected through brokers. At no time did taxpayer purchase or sell any securities with an investment motive. At various times taxpayer's officers dealt directly with principals. The taxpayer had no other business activities after April, 1961."

If evidence of the foregoing were before the lower court, there is no doubt but that it would shed light on the issues before the court.

After its Decision the lower court did request counsel to advise the court of the effect on its decision, if it ignored Greenwald's affidavit. [R. 261.] It is submitted that there would have been little before the lower court if it had, and that the pleadings do not allow for the result reached.

In its Decision the lower court erroneously characterized the following italicized statements as "undisputed facts." [R. 236.] If facts not elicited from the pleadings, admissions and interrogatories were to have been deleted, as is done below, the lower court quite obviously would not have had and did not have sufficient facts from which to make ultimate findings of fact or formulate a legal conclusion as to the correctness of plaintiff's contentions. It is too clear for citation of authority that representations of fact contained in memoranda and briefs filed by counsel do not constitute admissions for the purposes of a motion for summary judgment.

*"Prior to April, 1961, plaintiff was engaged in the business of manufacturing and selling sliding glass doors under the name of Fullview Corporation. Source: Plaintiff's Pre-trial Memorandum [R. 135]. In the spring of 1961 the plaintiff sold substantially all of its assets to Cal Tech Systems, Inc., receiving net cash proceeds therefor in the amount of \$1,041,271.00. Source: Greenwald Affidavit, ¶4 [R. 189]. This had been denied by defendant in response to plaintiff's Request for Admissions #9 [R. 56, 71]. Thereafter plaintiff changed its name to Mirro-Dynamics Corporation, discontinued its sliding glass door business and applied the proceeds from the sale to the purchase*

*of marketable securities.* Source: Greenwald Affidavit, ¶4 [R. 189]. *During the fiscal years ending October 31, 1961, and October 31, 1962, the plaintiff purchased and sold securities and conducted other miscellaneous stock transactions solely for its own account. During these years, plaintiff had accounts with several established brokerage firms and through these bought and sold a substantial number of securities, summaries of which were recorded in plaintiff's general ledger under an account entitled 'Stock Investment Account No. 123.'* Source: Greenwald Affidavit, ¶5 [R. 189]. Plaintiff had denied Defendant's Request for Admissions #13 in this respect [R. 99, 121]. *Plaintiff filed federal income tax returns for the years ending October 31, 1961, and 1962, the latter reporting a loss of \$905,861.47 from these security transaction and designating such loss as a capital loss.* Source: Greenwald Affidavit, ¶7 [R. 190]. Plaintiff had denied Defendant's Request for Admissions #2 in this respect [R. 96, 118]. *During these years neither the plaintiff nor its officers were members of any stock exchange, nor were they licensed or registered with the Securities and Exchange Commission as a broker or dealer in marketable securities, nor were they licensed or registered by the State of California to sell marketable securities to the general public."*

Although some of the foregoing unsupported facts may be immaterial, nevertheless, the lower court's decision that "under the above facts, and as a matter of law, plaintiff's loss of \$905,861.47 was a capital loss" [R. 237, 283] does not withstand scrutiny. Patently



there were genuine triable issues of fact, and the summary judgments should be reversed and a jury trial had. It should be noted that nowhere in the Findings or Conclusions did the lower court conclude that there were no genuine triable issues of material fact. This alone vitiates the judgments under this Court's opinion in *New and Used Auto Sales v. Hansen, supra*, 245 F. 2d at 953 (9th Cir. 1957).

### III.

#### **A Taxpayer's Business of Buying and Selling Securities Generates Ordinary Income or Loss Even if It May Not Inventory Securities Under Internal Revenue Regulations.**

The trial court bottomed its Decision on the premise that plaintiff could prevail only if it were a dealer and then concluded "as a matter of law that the plaintiff is not a dealer within the meaning of the Act." [R. 238-239.] Paragraph 2 of the Conclusions of Law provides [R. 283] that "The plaintiff is not a dealer in securities, *Schafer v. Helvering*, 299 U.S. 171 (1936); Commissioner's Regulations 1.471.5." There is no finding of fact that the plaintiff is or is not a dealer. [R. 277-282.]

It is submitted that the foregoing authorities bear only on the question of whether the plaintiff may inventory its securities and not on the issue of whether the business of buying and selling securities generated ordinary income or loss. Although there appears to be authority [*e.g.* the dictum in *Booth Newspapers, Inc.*, 303 F. 2d 916 (Ct. Cl. 1962) cited by the trial court [R. 238]] that only capital stock sold by dealers in the usual course of their business is not a capital asset,



this is not the law, or should not be the law, in light of recent judicial interpretations of the Internal Revenue Code. The issue relating to the question of whether the plaintiff could inventory its securities was initiated by the Internal Revenue Service itself when it maintained that since this taxpayer priced its inventories of manufactured sliding glass doors on a basis of cost or market, whichever is lower, it could not price its inventories of securities at cost, because this was an improper change of inventory pricing. [R. 259.] Whether the securities are priced at cost or market, whichever is lower, or at cost is not significant in the instant actions as the only inventory in question is as at October 31, 1961 and both the years 1961 and 1962 were before the court. If the taxpayer were required to use cost or market, whichever is lower, the closing inventory on October 31, 1961 would be lower with a concomitant reduction in 1961 income. Part of the loss from 1962 would be shifted to 1961. This would result in a larger operating loss carryback from the 1961 year to 1958, and a smaller carryback from 1962 to 1960. [See R. 87.]\* As the tax rate for all years concerned its 52%, the method of inventory pricing is not materially significant. However, the trial court never discussed inventory pricing and never determined whether the plaintiff did maintain inventories of its securities. [Cf. R. 258, line 28.] The trial court's decision states that plaintiff's securities were not a form of "business inventory within the meaning of the Internal Revenue Act" [R. 241, line 14], whatever that means. The plaintiff at no time urged that they were

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\*There would be no effect on the income for 1962 or any other year, as all securities were sold in 1962 and there was no ending inventory of securities.

*business* inventory and merely advanced the issue raised by the Internal Revenue Service as to what was the correct method of inventory pricing. Whichever method is correct, it is submitted that it has no bearing on whether the plaintiff's securities business generated ordinary income or loss.

It is conceded that in order to inventory securities the Regulations relating to inventories prescribe that one must be a dealer within the definition there set forth. However, the last phrase of Reg. §1.471-5, and its predecessor Reg. 118, §39.22(c)-5, in substantially identical language, specifically limits the Regulations' definition of dealer as follows:

"Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers *within the meaning of this section.*" (Italics added.)

THE INTERNAL REVENUE CODE DOES NOT, AND NEVER DID, DEFINE "DEALER" FOR THE PURPOSES OF THE BUSINESS LOSS PROVISIONS (§172) OR THE DEFINITION OF CAPITAL ASSETS (§1221). Furthermore, the Code does not provide that only dealers in securities are entitled to ordinary losses.

Whether plaintiff was a dealer within the meaning of this section of the Regulations (§1.471-5) or not, does not affect the question of whether the business of buying and selling securities generated ordinary losses, but only bears on the inventory issue. See *United*

*States v. Chinook Inv. Co.*, 136 F. 2d 984, 985 (9th Cir. 1943).

Unfortunately many decisions determining whether securities' transactions resulted in capital or ordinary gains or losses have been premised on a trichotomy with no clearly defined boundaries and without regard to the statutory provisions. This trichotomy, dealer—trader—investor, is not delineated either in the Code or the Regulations, and means different things to different people. Some of the problems defining the status of a stockbroker, *e.g.* dealer, broker, investment adviser, etc., are discussed in Levin & Evan, "PROFESSIONALISM AND THE STOCKBROKER," XXI *The Business Lawyer*, 337 (Jan. 1966). It is there pointed out (p. 339) that "The stockbroker may also serve as a *dealer*, in which status he buys or sells for his own, rather than his customer's, account. In this status as a principal, his compensation will result from the profit or 'spread' which he is able to make on the various securities he sells."

Consistent with this definition is that contained in the Securities Exchange Act of 1934, 15 U.S.C.A. §78c (1963 Ed.):

"(a) When used in this chapter, unless the context otherwise requires—

\* \* \*

(5) The term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business."

Apparently the lower court premised its conclusion that the plaintiff was not a dealer on the admitted fact that plaintiff bought and sold securities solely for its own account. Findings of Fact 14 and 15 [R. 282] state that the stock transactions were solely for plaintiff's account and were through several established brokerage firms. The lower court's Decision concludes that [R. 239]

"Since it is undisputed that the plaintiff purchased and sold securities solely for its own account and not *for* customers in the ordinary course of a trade or business or otherwise, it follows as a matter of law that the plaintiff is not a dealer within the meaning of the Act and that the securities are capital assets and may not properly be considered business inventory." (Italics added.)

Apparently the lower court was confusing the concept of "broker" with that of "dealer," as the facts found fit the Congressional definition of dealer, set forth above. 15 U.S.C.A. §78c(a)(4) (1963 Ed.) defines a broker as "any person engaged in the business of effecting transactions in securities *for* the account of others, but does not include a bank." (Italics added.) The fact that the lower court was concerned with whether it was *for* customers indicates that it did not have in mind whether the sales were *to* customers as used in Internal Revenue Code, §1221(1), which contains the statutory definition of capital asset. Whether plaintiff was a dealer or not is immaterial, in light of this Court's ruling in *United States v. Chinook Inv. Co.*, 136 F. 2d 984, 985 (9th Cir. 1943) that "The question before us relates to the status of assets rather than to the status of the taxpayer."

In that case, the taxpayer had been organized “to own, buy, sell, or to acquire” bonds, stocks, and other securities.

“For many years it regularly followed that calling, maintaining an office for the transaction of its business and buying and selling upwards of \$300,000 worth of securities yearly. Its management kept in close touch with the market, subscribed to financial periodicals, and bought and sold securities at private sale, ‘at random,’ ‘over the counter,’ and ‘listed securities.’ Unlisted securities dealt in were sometimes those of local companies with whose business the taxpayer was familiar. Purchases were often made direct from the owners of stock, and taxpayer was frequently approached by brokers who had securities to buy or sell. Persons or concerns believed to be interested in making sales or purchases were solicited, and securities were bought or sold when it was thought the market justified. The transactions were not on margin, but for cash, and there was a capital turnover about once each year. In the acquisition of securities, ‘investment was not the idea of the Company.’ ” 136 F. 2d at 984.

This Court concluded that it was impossible to categorize this taxpayer definitively, despite a contention by the Government, as here, that the taxpayer was not a dealer entitled to inventory securities under *Schafer v. Helvering* and Regulation 94, Art. 22(c)-5. This regulation, the precursor of §1.471-5, was deemed irrelevant to the issue and the *Schafer* case ruled to be not decisive. Since the taxpayer was regularly engaged in the business of buying and selling stocks and bonds.

and the securities dealt in were held primarily for sale to customers in the ordinary course of the taxpayer's business and not for investment or speculation, the taxpayer's losses were not capital losses. "The statute appears to speak for itself." 136 F. 2d at 985.

Aside from the issue regarding securities' inventory, the pertinent language of the statute, §1221(1), insofar as this taxpayer is concerned, excludes from the definition of capital assets:

"property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

Each phrase in this exclusionary clause bears analysis.

**A. PROPERTY Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His Trade or Business.**

In the *Chinook Inv.* case, *supra*, this Court held (136 F. 2d at 985) that securities were "property" within the meaning of the predecessor of §1221(1), §117(b).

**B. Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His TRADE or BUSINESS.**

Congress has not defined the phrase "trade or business." See *Kales v. Com'r*, 101 F. 2d 35, 37, 38 (6th Cir. 1939), cited in *Miller v. Com'r*, 102 F. 2d 476, 480-481 (9th Cir. 1939). "Despite statements that the words 'trade or business' have 'many shades of meaning, and are subject to colloquial abuses,' *Hughes v. C.I.R.*, 38 F.2d 755, 759 (10 Cir. 1930), the courts, quite understandably, have not regarded the various sections of the Code using that term as water-tight com-



partments.” *Trent v. Com’r*, 291 F. 2d 669, 671 (2d Cir. 1961).

Although the findings of fact do not reflect the taxpayer’s trade or business, the lower court’s Decision indicates that the judge apparently felt [R. 243] that the taxpayer was “engaged in the business of buying and selling securities on its own behalf” and was “at the most a trader on his (sic) own account.”

However, it is the law of this Circuit, based on *Stone v. United States*, 164 U.S. 380, 383, that:

“ . . . when the trial court does make formal findings, they alone serve as the court’s findings of fact. In the words of the Supreme Court: ‘We are not at liberty to refer to the opinion for the purpose of eking out, controlling or modifying the scope of the findings.’ ” *Ohlinger v. United States*, 219 F. 2d 310, 311 (9th Cir. 1955).

Accordingly, there is nothing in the record (*United States v. U.S. Gypsum Co.*, 51 F. Supp. 613, 634 (D.C. D.C. 1943)) determining what the taxpayer’s business was. Apparently, the defendant took the position in its motion for summary judgment that “Whether or not the plaintiff was in the business of buying and selling securities *per se* is not material to a determination of whether or not its securities were capital assets.” [R. 205.] Yet, after the lower court’s Decision was filed, the defendant apparently “acknowledged” in its Memorandum in Opposition filed September 9, 1965,\* that

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\*Prior to the lower court’s Decision and this “acknowledgement,” there was nothing before the court from which it could determine the taxpayer’s motives and intent in order to satisfy the criteria set forth in the very case which the trial court cited [R.



[R. 256H] “plaintiff was in the business of buying and selling marketable securities for a profit” and conceded the veracity of plaintiff’s response to Interrogatory 12 [R. 125]:

“The purpose of plaintiff’s purchases and sales of securities, puts and calls, and rights to purchase securities was in each instance in furtherance of its business, the business of buying and selling securities to make a profit as soon as possible. The plaintiff at no time purchased or sold securities with an investment motive . . .”

The cases discussing what activities will result in the status of a trade or business have yielded myriad criteria for the various sections of the Code, requiring such a determination.

As early as 1931, the Commissioner of Internal Revenue ruled in Mim. 3883, X-2 Cum. Bull. 180, that “Whether or not a taxpayer’s activities, and particularly his activities involving stock market transactions, constitute a ‘trade or business’ as that term is contemplated by the statutory provisions is purely a question of fact in each case, and no general rule can be laid down which would be determinative of this issue in all cases in which the question arises.” Among the cases cited by the Commissioner was *Ignaz Schwinn*, 9 B.T.A. 1304 (1928), *acq.* VII-1 Cum. Bull. 28, in

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238], *Booth Newspapers, Inc. v. U.S.*, 303 F. 2d 916, 921 [Ct. Cl. 1962]:

“Thus the circumstances of the transaction (its factual background, the necessities of the particular business involved at the particular time involved, and the intentions of the taxpayer, both at the time the securities were originally purchased and at the time they were disposed of) are of crucial importance in the resolution of these cases. The fact that securities are ‘property,’ in the broad sense of that term, is not conclusive.”

which it was held that where the taxpayer devoted the largest part of his business time to, and made the most money from, speculating in stocks, grain and other commodities, and had large sums of money involved in his margin dealings, having had 112 transactions in commodities and 15 in securities in 1923, and 91 transactions in commodities and 30 in securities in 1924, the taxpayer's loss resulting from the purchase and sale of 2,300 shares of Anaconda copper stock was a loss sustained in 1924 with respect to property held primarily for sale in the course of the taxpayer's trade or business and not a capital loss. In *Snyder v. Com'r*, 295 U.S. 134 (1935), *reh. den.* 55 S. Ct. 913, the Supreme Court indicated that, although in that case the taxpayer did not allege or attempt to prove that he had devoted the major part, or any substantial part, of his business day to his transactions, if he had done so the result of the case might have been different. The Court stated: "It is also true that the Department has ruled, and the board has held, that a taxpayer who, for the purpose of making a livelihood, devotes the major portion of his time to speculating on the stock exchange may treat losses thus incurred as having been sustained in the course of a trade or business," citing *Ignaz Schwinn, supra*. The taxpayer should at least be allowed to prove its activities in this regard, and not be summarily denied this opportunity by having the case decided on a motion for summary judgment.

This Court, in *Maloney v. Spencer*, 172 F. 2d 638, 640 (9th Cir. 1949), spelled out the criteria for determining the taxpayer's business status as follows:

"Here the taxpayer's activities were 'extensive, varied, continuous and regular' as in *Daily Journal*

Co. v. Commissioner, 9 Cir., 135 F. 2d 687, 688, and Miller v. Commissioner, 9 Cir., 102 F. 2d 476. Here is the 'frequency and continuity of the transaction' resulting in a business status of Commissioner v. Boeing, 9 Cir., 106 F. 2d 305, 319, certiorari denied 308 U.S. 619, 60 S. Ct. 295, 84 L. Ed. 517. Here the taxpayer was engaged in two businesses as in Daily Journal Co. v. Commissioner, supra, 135 F. 2d 689, and Harvey v. Commissioner, 9 Cir., 171 F. 2d 952. Like the instant case are Fackler v. Commissioner, 6 Cir., 133 F. 2d 509; Kales v. Commissioner, 6 Cir., 101 F. 2d 35, 122 A.L.R. 211; Foss v. Commissioner, 1 Cir., 75 F. 2d 326.

"Here is the 'regularity' as distinguished from the 'isolated or occasional transactions' of Burnet v. Clark, 287 U.S. 410, 424, 425, 53 S. Ct. 207, 77 L. Ed. 397 and Dalton v. Bowers, 287 U.S. 404, 53 S. Ct. 205, 77 L. Ed. 389. Also is the multiplicity of transactions required by the several leases creating a business obligation to the corporations as distinguished from the 'single transaction' occurring in the 'lifetime' of the taxpayer 'but once' of Deputy v. DuPont, 308 U.S. 488, 495, 60 S. Ct. 363, 84 L. Ed. 416."

"... one may be 'regularly engaged in the business of buying and selling corporate stocks.'" *Snyder v. Com'r*, 295 U.S. 134, 139 (1935). "A trader on an exchange, who makes a living in buying and selling securities or commodities, may be said to carry on a 'business';" *Bedell v. Com'r*, 30 F. 2d 622, 624 (2d Cir. 1929). For the purpose of determining the taxability of non-resident aliens, the courts have generally held

that "extensive trading in stocks and commodities constituted engaging in trade or business within the meaning of the statute. See *Snyder v. C.I.R.*, 295 U.S. 134, 139, 55 S. Ct. 737, 79 L. Ed. 1351; *Field v. C.I.R.*, 2 Cir., 139 F. 2d 465; *Adda v. C.I.R.*, 10 T.C. 273, affirmed, 4 Cir., 171 F. 2d 457, certiorari denied 336 U.S. 952, 69 S. Ct. 883, 93 L. Ed. 1107;" *Com'r v. Nubar*, 185 F. 2d 584, 588 (4th Cir. 1950).

Although the *Adda* case cited in *Nubar* involved commodities and not stocks, the language of the Tax Court, 10 T.C. 273, 277, affirmed per curiam, 171 F. 2d 457 (4th Cir. 1948) cert. denied 336 U.S. 952, shows that the Government there urged the position taken by this taxpayer:

"Trading in commodities for one's own account for profit may be a 'trade or business' if sufficiently extensive. *Fuld v. Commissioner*, 139 F. 2d 465; *Norbert H. Wiesler*, 6 T.C. 1148, affirmed without discussion of this point 161 F. 2d 997. The respondent determined that the petitioner was engaged in trade or business in the United States. While the number of transactions or the total amount of money involved in them has not been stated, it is apparent that many transactions were effected through different brokers, several accounts were maintained, and gains and losses in substantial amounts were realized. This evidence shows that the trading was extensive enough to amount to a trade or business, and the petitioner does not contend, nor has he shown that the transactions were so infrequent or inconsequential as not to amount to a trade or business."

In *Fuld v. Com'r*, 139 F. 2d 465, 469 (2d Cir. 1943), the court concluded that

“it may fairly be said that persons engaged in speculating through brokers whether in merchandise or in securities may equally hold themselves out as engaged in business. We so held in *Winmill v. Commissioner*, 2 Cir., 93 F. 2d 494, and while that decision was reversed in *Helvering v. Winmill*, 305 U.S. 79, 59 S. Ct. 45, 83 L. Ed. 52, the reversal was only on the ground that brokers’ commissions in such a business were to be treated as part of the price of securities rather than as a current expense of the business. See also, *Neuberger v. Commissioner*, 2 Cir., 104 F. 2d 649, reversed on other grounds, 311 U.S. 83, 61 S. Ct. 97, 85 L. Ed. 58. The Supreme Court in *Spreckels v. Commissioner*, 315 U.S. 626, 62 S. Ct. 777, 86 L. Ed. 1073, apparently assumed that a taxpayer buying and selling securities on his own account was engaged in a trade or business, through there again the critical question was whether the commissions paid a broker by one speculating on his own account were part of the cost of the securities or a business expense.”

This Court in numerous instances has had occasion to consider what is a trade or business in connection with other “property,” viz. real estate. In *Pool v. Com'r*, 251 F. 2d 233, 235 (9th Cir. 1957), *cert. denied*, 356 U.S. 938, this Court cited from *Stockton Harbor Ind. Co. v. Com'r*, 216 F. 2d 638, 650 (9th Cir. 1954):

“What is and what is not trade or business and when property is or is not held for sale to customers are questions of fact.

“Provisions similar to the one under discussion have been part of our tax statutes for many years. Courts have sought to evolve criteria by which to determine whether a person or an association was engaged in business. More particularly, they have tried to establish criteria by which to determine whether real property is held for investment or sale to customers in the ordinary course of business. Many tests have been proposed by this and other courts. Among them are: (1) the nature of the acquisition of the property, (2) frequency and continuity of sales over a period of time, (3) the nature and extent of the taxpayer’s business, (4) the activity of the seller about the property, such as the extent of his improvements or his activity in promoting sales, (5) the extent and substantiality of the transaction and the like. \* \* \* But in the last analysis, each case must be determined upon its own specific facts, for none of these incidences are present in all cases.”

There is no doubt but that this Court’s decisions compel the conclusion that §1221(1) must be consistently construed by this Court irrespective of the nature of the property under consideration, whether securities, cattle, hogs, or real property. *United States v. Chinook Inv. Co.*, *supra*, 136 F. 2d at 985 (9th Cir. 1943). One of the earliest decisions from this Court on business status was *Com’r v. Boeing*, 106 F. 2d 305 (9th Cir. 1939), *cert. denied*, 308 U.S. 619, involving the question of whether the taxpayer was in the business of selling logs. This Court concluded at page 309 that “the facts necessary to create the status of one engaged in a ‘trade or business’ revolve largely around the frequency or



continuity of the transactions claimed to result in a 'business' status."

The legislative history of this section is necessary to orient the Court as various decisions have dealt with predecessor sections as amended from time to time.

Prior to 1921 there was no provision in the income tax law for extraordinary treatment of gains from the sale of capital assets. The Revenue Act of 1921 added a section defining capital assets as "property acquired and held by the taxpayer for profit or investment for more than two years . . . but does not include . . . stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer. . ." §206(a)(6), Act of November 23, 1921, c. 136, 42 Stat. 227, 232. The result of this addition was to grant preferential treatment to sales of certain assets excluding property which under the best accounting practice for the particular trade or business in question would be considered stock in trade or inventory items. H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10-11 [1939-1 Cum. Bull. (Part 2) 176]; S. Rep. No. 275, 67th Cong., 1st Sess., pp. 12-13 [1939-1 Cum. Bull. (Part 2) 189-190]. Since real estate would not ordinarily be included in an inventory, it did not fall into the exclusion and gains from the sale thereof would always be capital gains.

In 1924 the definition of capital assets was amended by adding to the excluded items "property held by the taxpayer primarily for sale in the course of his trade or business." Rev. Act of 1924, §208(a)(8), Act of June 2, 1924, c. 234, 43 Stat. 253. The purpose of this amendment was said to be "to remove any doubt as to whether property which is held primarily for resale con-



stitutes a capital asset, whether or not it is the type of property which under good accounting practice would be included in the inventory.” H. Rep. No. 179, 68th Cong., 1st Sess. p. 19 [1939-1 Cum. Bull. (Part 2) 255]; S. Rep. No. 398, 68th Cong., 1st Sess., p. 22 [1939-1 Cum. Bull. (Part. 2) 281]. Under this version of the statute a taxpayer carrying on “business through agents whom he supervises” for the purpose of selling land, was held to have ordinary gain from sales of land which had been held primarily for sale in the course of his business. *Snell v. Com’r*, 97 F. 2d 891, 893 (5th Cir. 1938); *Richards v. Com’r*, 81 F. 2d 369 (9th Cir. 1936).

If Appellant were afforded an opportunity to lay before a jury the extent of its *only* activities during the period in question, it could clearly establish that its trade or business was buying and selling securities. See, *Kelley v. Com’r*, 281 F. 2d 527, 529 (9th Cir. 1960).

**C. Property Held by the Taxpayer Primarily for Sale to CUSTOMERS in the Ordinary Course of His Trade or Business.**

In 1934 Congress amended the statutory exception to read “property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business.” Revenue Act of 1934, §117(b), Act of May 10, 1934, c. 277. 48 Stat. 680 (words in italics added in 1934). According to the House Conference report, this was done to make “it impossible to contend that a stock speculator trading on his own account is not subject to the provisions of section 117.” H. Conf. Rep. No. 1385, 73rd Cong., 2nd Sess., p. 22 (Amend. No. 66) [1939-1 Cum. Bull. (Part 2) 632]. However, the significance of the additional words was considered by

this Court in *Ehrman v. Com'r*, 120 F. 2d 482, 485 (9th Cir. 1941), *cert. denied* 314 U.S. 668. In that case it was "urged that the addition of these words indicate an intention by Congress to exclude from taxation as ordinary gains sales such as the ones with which we are here concerned."

"We do not agree. If, as we have held the fact to be here, the taxpayers were in the 'trade or business' of real estate subdivision, then certainly the sales of lots were to 'customers' in the 'ordinary' course of that business."

This conclusion is apparently consistent with the current position of the Government, as urged to the Supreme Court in its brief in the *Malat* case, *supra*. In response to the taxpayer's contention that a sale between joint venturers was not a sale to customers in the ordinary course of business, the Solicitor General argued (pp. 29-30):

"The courts have long held that anyone engaged in the business of selling property sells it to customers whenever he finds someone who will purchase it. In one frequently cited case the Board of Tax Appeals held that:

Where, as here, one is regularly engaged in the business of buying and selling real estate, as was petitioner, any person who can be found to buy such property is a customer as that term is ordinarily understood, and where such property is held for sale under such circumstances it must be deemed to be held for sale to customers within the meaning of the statute. [*Black v. Commissioner*, 45 B.T.A. 204, 210.]

As Judge Learned Hand stated the same principle, those 'whose custom the taxpayer seeks \* \* \* are

his "customers." ' *Goldsmith v. Commissioner*, 143 F. 2d 466, 468 (C.A. 2), certiorari denied, 323 U.S. 774. See also *Gamble v. Commission*, decided October 27, 1955 (P-H Memo T.C., para. 55,289, affirmed, 242 F. 2d 586 (C.A. 5) ('one engaged in the continuous purchase and sale of property, as this petitioner was, has dealings with a "customer" whenever he sells.');

*Pennroad Corp. v. Commissioner*, 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc. v. Commissioner*, 359 U.S. 958; *Stockton Harbor Industrial Co. v. Commissioner*, 216 F. 2d 638 (C.A. 9), certiorari denied, 349 U.S. 904. Cf. *Watson v. Commissioner*, 345 U.S. 544."

The Tax Court has adopted a like view with respect to the sale of patents. *M. L. Lockhart*, 16 TCM 474, 477; *H. T. Avery*, 47 B.T.A. 538.

Although the statute may have been amended in 1934, with security traders in mind, there is nothing in the statute limiting the application of the language there set forth to stock speculators or otherwise. As the Supreme Court pointed out in its very recent decision in *Malat, supra*, 383 U.S. at 572:

"The purpose of the statutory provision with which we deal is to differentiate between the 'profits and losses arising from the everyday operation of a business' on the one hand (*Corn Products Co. v. Commissioner*, 350 U.S. 46, 52) and 'the realization of appreciation in value accrued over a substantial period of time' on the other. (*Commissioner v. Gillette Motor Co.*, 364 U.S. 130, 134). A literal reading of the statute is consistent with this legislative purpose."

In view of this Court's decision in *United States v. Chinook Inv. Co.*, *supra*, 136 F. 2d at 985, that §117(b) of the Revenue Act of 1936, containing substantially identical language to §1221(1), "is not concerned with securities alone, but deals with all 'property,'" and that there was a "regular business roughly comparable with that of a dealer in hogs or cattle or town lots, finding its customers where it could.", there is no doubt that the statute must be read and interpreted consistently for those whose business is the sale of securities, hogs, cattle, and town lots. See, *Pool v. Com'r*, 251 F. 2d 233 (9th Cir. 1957), *cert denied*, 356 U.S. 938.

It is further immaterial how a taxpayer conducts his business, whether through agents or brokers. *Welch v. Solomon*, 99 F. 2d 41, 43 (9th Cir. 1938); *Margolis v. U.S.*, 337 F. 2d 1001, 1007, reh. 339 F. 2d 357 (9th Cir. 1964). As a necessary corollary, it is immaterial that the taxpayer's agent may locate a purchaser or a purchaser's agent on an exchange. The method of selling described in the *Pool* case, *supra*, 251 F. 2d at 243-246, was considered immaterial in that the taxpayers did not deal with the individual purchasers and had no idea who their customers were, *e.g.* "Most of the paper work was in the name of the taxpayers, who executed escrow instructions and deeds in blank long in advance of a sale." 251 F. 2d at 248. Similarly, this Court, in characterizing as ordinary, and not capital, gains from the sale of subdivided ranch property held in *Kelley v. Com'r*, 281 F. 2d 527, 529 (9th Cir. 1960):

"That taxpayers . . . used the services of a real estate broker in transacting sales does not compel capital gains treatment. See *Ehrman v. Commissioner*, 120 F. 2d 607 (9th Cir.) *cert. denied*, 314

U.S. 668 (1941); *Welch v. Solomon*, 99 F. 2d 41 (9th Cir. 1938); *Richards v. Commissioner*, 81 F. 2d 369 (9th Cir. 1936)."

If necessary, expert testimony could be introduced at a trial of the instant actions to show that over-the-counter brokers who inventory unlisted securities, odd lot dealers, and specialists (see *Vaughn v. Com'r*, 85 F. 2d 497, 499 (2d Cir. 1936), *cert. denied*, 299 U.S. 606), often sell securities to undisclosed persons through brokers, at the same time realizing ordinary income and loss on all their sales. The confusion surrounding the various appellations given to those in the securities' business is shown by Judge L. Hand's conclusion in *Seeley v. Helvering*, 77 F. 2d 323 (2d Cir. 1935). In that case, which involved the question of whether the taxpayer was entitled to compute his income by use of inventories, the taxpayer was "what is commonly known as a 'floor trader,' and he had no personal customers." Yet in holding that the taxpayer was not entitled to inventory securities because he did not fit the definition of dealer set forth in the regulations, Judge Hand said: "A 'floor trader' would indeed be quite naturally described as a 'dealer in securities,' but nobody would think of calling him a 'merchant' with 'customers.'" 77 F. 2d at 324.

In light of the foregoing obfuscating appellations given to those in the business of dealing in securities,\*

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\*In *Dart v. Com'r*, 74 F. 2d 845, 847 (4th Cir. 1935), an action involving the deductibility of dividends paid consequent to a short sale, the court rejected a distinction urged by the Government that there was a difference between dealers who are engaged in carrying on a trade or business in the buying and selling of securities and those who are not dealers but buy and sell securities for their own account. This opinion allowing such short dividends as a business expense was followed by this Court in *Com'r v. Wilson*, 163 F. 2d 680, 682 (9th Cir. 1947) *cert. denied* 332 U.S. 842.

it is quite apparent that irrespective of whether the taxpayer knows the person to whom he sells, whether via the medium of another broker or through an exchange, if he is in the business of buying and selling securities, hogs, cattle or town lots, the same result should obtain: ordinary income and loss. This in effect is the result reached in *Margolis v. Com'r*, 337 F. 2d 1001, 1004, reh., 339 F. 2d 537 (9th Cir. 1964), in which this Court concluded:

“Where one is engaged in the business of buying and selling real estate on as broad a basis as was taxpayer, the fact that property was acquired with the intention of holding it for a substantial period of time before sale, is not sufficient to constitute it an investment. If the purpose of the acquisition and holding and the only manner in which benefit was to be realized from the property acquired was ultimate sale at a profit, its acquisition and holding by a dealer such as taxpayer must be considered to have been for sale to customers in the ordinary course of business.”

#### IV.

#### **Federal Transfer Taxes Incurred on the Sale of Securities by a Taxpayer Whose Business Is That of Buying and Selling Securities Are Deductible as an Ordinary and Necessary Business Expense.**

Conclusion of Law, paragraph 5, unconditionally provides that federal stamp taxes paid on the sale of securities are not deductible as an ordinary and necessary business expense, but are offsets against the selling price.



Under the well-reasoned decision in *Hirshon v. U.S.*, 113 F. Supp. 444, 445 (Ct. Cl. 1953):

“If one’s business is that of trading in stocks, and if he must pay a tax whenever he trades, the tax would seem to be an ordinary and necessary business expense, and therefore deductible under the express terms of the statute.”

Accordingly, such federal stamp taxes are deductible by this taxpayer, in view of its activities in buying and selling stocks, and the net operating loss for the 1962 fiscal year should be further increased by \$1,592.60, the federal transfer taxes paid in that year.

### Conclusion.

Since the District Court erred in denying the plaintiff the right to a trial on the issues involved, the judgment appealed from should be reversed.

Respectfully submitted,

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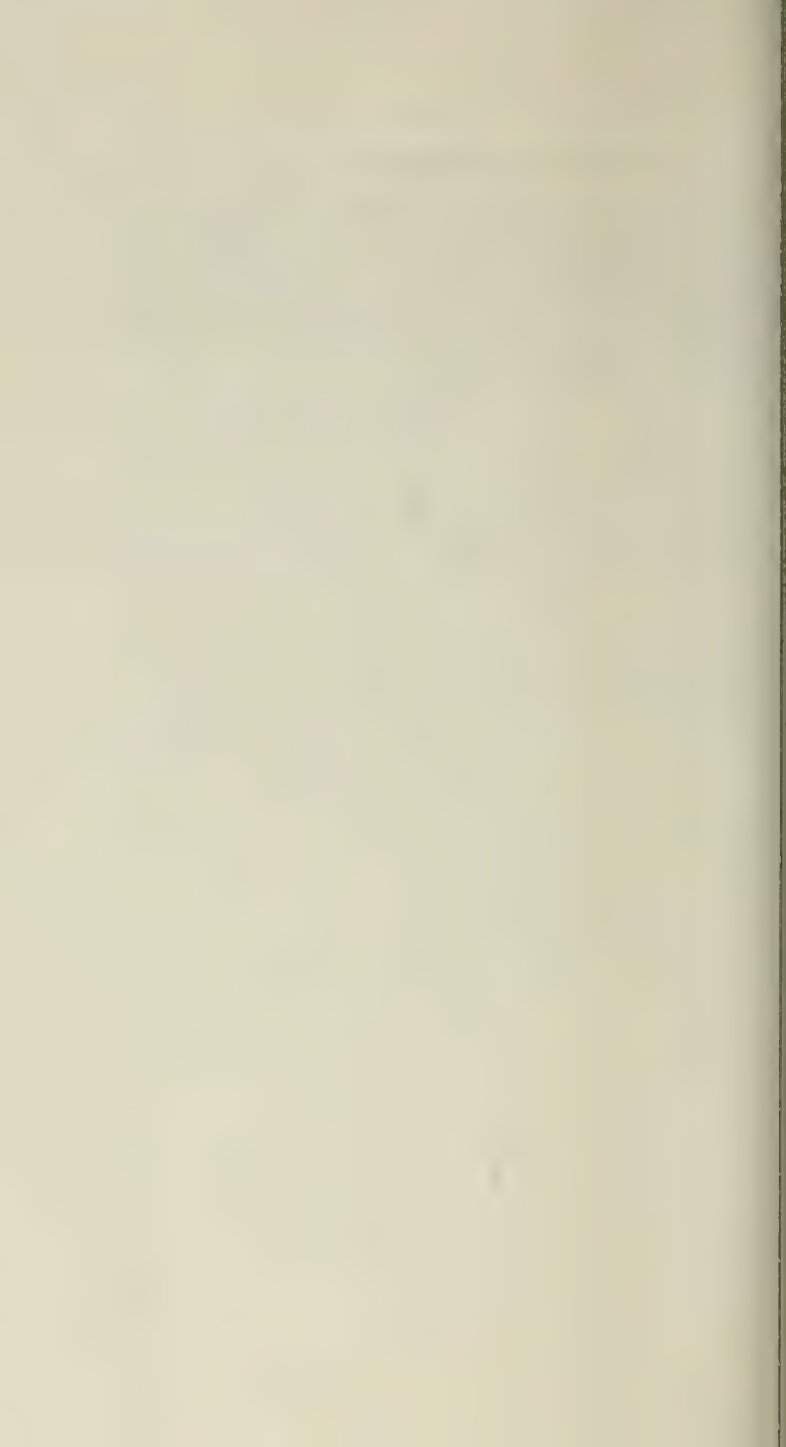
Dated: September 19, 1966.



### **Certificate.**

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

ROBERT H. WYSHAK



Nos. 20799-20801

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**MIRRO-DYNAMICS CORPORATION, APPELLANT**

*v.*

**UNITED STATES OF AMERICA, APPELLEE**

---

**ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES  
DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALI-  
FORNIA**

---

**BRIEF FOR THE APPELLEE**

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---

*ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES  
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FORNIA*

---

## BRIEF FOR THE APPELLEE

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### OPINION BELOW

The decision of the District Court is reported at 47 F. Supp. 214. The findings of fact and conclusions of law (R. 277-284) <sup>1</sup> are not officially reported.

### JURISDICTION

This appeal involves federal income taxes. The taxpayer claims to have overpaid its federal income taxes for its fiscal years ended October 31, 1958, 1959, 1960. (R. 3, 303, 334.) Claims for refund totalling \$17,909.33 were filed on September 6 (R. 4, 336) and November 8, 1963 (R. 305). Within the time provided in Section 6532 of the Internal Revenue Code of 1954, on May 22, 1964, the taxpayer brought these actions

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<sup>1</sup> "R" references are to the Transcript of Record on appeal.

in the District Court for the recovery of taxes paid (R. 2, 303, 334). Jurisdiction was conferred on the District Court by 28 U.S.C., Sections 1340, 1346 (a)(1). The actions were consolidated for trial and decision. (R. 52, 235, 278.) Summary judgment was entered on November 23, 1965. (R. 286.) Within 60 days, on January 19, 1966, a notice of appeal was filed. (R. 289.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

#### QUESTIONS PRESENTED

(1) Whether the District Court correctly held that losses from the sale of securities by the taxpayer were capital losses.

(2) Whether the District Court correctly held that the taxpayer could not properly inventory its securities.

(3) Whether the District Court properly granted a motion for summary judgment in favor of the Government.

(4) Whether the District Court correctly held that the federal stock transfer taxes paid by the taxpayer were not currently deductible.

#### STATUTES AND REGULATIONS INVOLVED

The statutes and regulations are set forth in the Appendix, *infra*.

#### STATEMENT OF FACTS

The material undisputed facts in this case are as follows. The taxpayer is a California corporation located in Los Angeles. Prior to April, 1961, the taxpayer manufactured and sold sliding glass doors under

the names Fullview Corporation and Pacific Bolt Corporation. (R. 5, 65.) In the spring of 1961, it sold substantially all of the assets of its manufacturing business and received over one million dollars in cash. (R. 5, 71.) The taxpayer changed its name to Mirro-Dynamics Corporation, discontinued its sliding glass door business, and opened accounts with brokers in order to engage in the buying and selling of securities. (R. 5, 71-72.) Within a few months it had purchased over \$3,000,000 worth of securities in hundreds of different transactions. (R. 5, 7-12.) During its next year, fiscal year ended October 31, 1962, the taxpayer sold securities worth over \$4,000,000 and incurred a net loss of close to \$900,000. (R. 5, 13-21.) The taxpayer paid federal stock transfer taxes on the transfer of securities for 1962. (R. 243, 281.)

The taxpayer admits that it bought and sold securities solely for its own account. (Br. 39; R. 237, 282.) The public placed no orders with the taxpayer to buy and sell securities. The taxpayer did not advertise to obtain business, for it was not a member of any stock exchange, or licensed as a broker-dealer with the Securities and Exchange Commission, or permitted by California law to conduct a business of selling securities to the public or of buying securities for the purpose of resale. (R. 5, 128-130, 135, 185-C, 237, 282, 306, 337.)

In the District Court, the taxpayer claimed that the loss it incurred in 1962 on the sale of its securities was an ordinary loss which could be carried back as a net operating loss to 1959 and 1960, producing a tax refund for those years. (R. 231.) The Government

contended that the loss was a capital loss and, thus, did not qualify as a net operating loss. (R. 237.) The taxpayer also claimed that as a consequence of repricing its closing securities inventory for 1961, it was entitled to an additional net operating loss to be carried back to 1958. (R. 236.) The Government contended that the taxpayer was not a dealer in securities and therefore could not inventory its securities at all. (R. 239.) Finally, the taxpayer claimed a current deduction for federal stock transfer taxes it paid on the transfer of securities for 1962. (R. 236.) The Government took the position that those payments were not currently deductible but should be added to the basis of the securities, reducing any gain or loss on sale. (R. 241.) The Government moved for summary judgment (R. 186), and the District Court held that on the undisputed facts, the Government was entitled to judgment as a matter of law. (R. 286-287.)

#### SUMMARY OF ARGUMENT

1. Upon receiving over one million dollars in cash from the sale of the assets of its manufacturing business, the taxpayer opened accounts with brokers and busied itself buying and selling securities. Its purchases and sales of securities were exclusively for its own account. Not being licensed as a broker-dealer in California, it was prohibited by law from having customers. Unable to buy or sell directly on a stock exchange or in the over-the-counter market, its source of supply of securities could be no different than that

of anyone else with the same available amount of money.

Faced with a substantial net loss as a consequence of its securities activities, the taxpayer seeks the tax advantage of having its losses treated as ordinary losses rather than capital losses from the sale of capital assets. Its central argument appears to be that its securities are not capital assets but that they were held for sale "to customers" in the ordinary course of business. In view of the status of the assets and the taxpayer, however, it is difficult to see how it could have customers—except in the sense that any sale of securities is a sale to an ultimate customer. But the taxpayer contends that only the status of the asset is important; the status of the holder of the asset is unimportant. If that were true, then gain or loss on the sale of securities—the clearest kind of "natural" capital assets—would always be capital. The taxpayer goes on to claim that so long as one is in business, all sales are made "to customers." Except for the precise type of activity we are concerned with in this case—buying and selling securities and similar rights—that proposition may well be true.

When Congress added the term "to customers" to the predecessor of Section 1221(1) it sought thereby to halt the revenue loss caused by excessive deductions of securities losses by non-dealers. The fact that the securities activity may rise to the level of a business due to the expenditure of a large amount of time, attention, and funds and may therefore produce losses of even greater magnitude is all the more reason for treating such losses as capital losses. The legislative



purpose of the “to customers” language also explains why the *Corn Products* doctrine—everyday business profits and losses are ordinary income and losses—is inapplicable in this case. Even as to commodity futures, the precise assets involved in *Corn Products*, it has consistently been held that gain or loss from the business of trading futures (as opposed to hedging) is capital gain or loss.

The undisputed facts of this case establish that this taxpayer could not have held securities for sale “to customers” within the meaning of the statute. For similar reasons, the taxpayer could not properly inventory its securities. Accordingly, the District Court properly granted a summary judgment on these issues in favor of the Government.

2. The District Court also correctly held that federal stock transfer taxes paid by the taxpayer on the purchase and sale of securities for 1962 are not currently deductible. The Code contains no specific provision permitting such taxes to be deducted. To qualify as deductions, the stock taxes would have to come within the general business expense provision, Section 162. One limitation of that section is the principle that capital expenditures—*e.g.* costs directly connected to the acquisition and disposition of capital assets—are not currently deductible. A tax payable only on the transfer of capital assets (the securities in this case) can scarcely be more directly connected to the acquisition and disposition of capital assets. Accordingly, the federal stock transfer tax should be added to basis, thereby reducing the amount of gain or loss on sale of the stock.



## ARGUMENT

**I. The District Court correctly held that losses from the sale of securities by the taxpayer were capital losses****A. Introduction**

When the taxpayer sold substantially all the assets of its manufacturing business in 1961, it received over one million dollars in cash. (R. 5, 71, 237, 282, 306, 337.) Instead of distributing the cash to its shareholders in liquidation, the taxpayer opened accounts with brokers, devoted itself exclusively to buying and selling securities, and purchased over \$3,000,000 of securities within a few months. (R. 5, 135, 237, 282, 306, 337.) The taxpayer was not a member of any stock exchange, or licensed as a broker or dealer by the Securities and Exchange Commission, or licensed by California to sell securities to the public. (R. 128, 129-130, 237, 282.) Accordingly, the public placed no orders with the taxpayer to buy or sell securities, and the taxpayer bought and sold securities solely for its own account. (R. 5, 129, 185-C, 237, 282, 306, 337.)

From the sale of securities in 1962, the taxpayer claims a net loss of close to \$900,000. (R. 74.) There is no dispute that the loss was incurred. The issue is whether it is an ordinary or a capital loss. If an ordinary loss, it may be carried back as a net operating loss to 1959 and 1960, producing a tax refund for those years. Section 172, Internal Revenue Code of 1954, Appendix, *infra*. On the other hand, if the loss is a capital loss, it does not qualify as a net operating loss and may be carried forward to future years only. Sections 172(c), 1211(a), Internal Revenue Code of 1954, Appendix, *infra*. The characterization of the

taxpayer's net loss as capital or ordinary turns on whether the securities it sold were capital assets.

#### B. The securities were capital assets

To determine whether the District Court was correct in holding (R. 241, 283) that the securities were capital assets, we start with the words of the applicable statute. Section 1221 of the Internal Revenue Code of 1954, Appendix, *infra*, provides, with certain exceptions, that "the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business)." The taxpayer's securities satisfy that definition. The issue is whether they fall within the exceptions contained in Section 1221 (1) which provides that a capital asset does not include:

stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; \* \* \*

The securities of the taxpayer are not properly includible in its inventory.<sup>2</sup> The basic inventory section allows securities to be included in inventory only by a dealer—*i.e.* "a merchant of securities \* \* \* regularly engaged in the purchase of securities and their resale to customers \* \* \*." Treasury Regulations on

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<sup>2</sup> Since the taxpayer may not properly inventory its securities at all, *a fortiori* it may not reprice its closing "inventory" of securities for 1961 and obtain an increased net operating loss deduction to be carried back and used for the year 1958. (R. 239, 241, 281, 283, 303, 307.)

Income Tax (1954 Code), Sec. 1.471-5; Appendix, *infra*. That regulation goes on to provide that taxpayers "who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business \* \* \* are not dealers in securities \* \* \*." Taxpayers which buy and sell securities for their own account (as did this taxpayer (R. 5, 128-130, 237, 282)) are not dealers but are traders or investors and may not inventory their securities. *Schafer v. Helvering*, 299 U.S. 171 (1936); *Helvering v. Fried*, 299 U.S. 175 (1936); *Commissioner v. Burnet*, 40 B.T.A. 605 (1939), affirmed in part, 118 F.2d 661 (C.A. 10th, 1935); *Adirondack Securities Corp. v. Commissioner*, 23 B.T.A. 61 (1931); *Oil Shares, Inc. v. Commissioner*, 29 B.T.A. 664 (1934). As the District Court held, the taxpayer's (R. 241) "Securities do not constitute business inventory within the meaning of the Internal Revenue Act."

The taxpayer argues (Br. 35-41) that even though its securities are not includible in inventory under Section 471, they are, nevertheless, includible in inventory under Section 1221(1). The taxpayer does not support its reading of the term "inventory" either by legislative history or decisional law. We have found nothing that gives the vaguest indication that Congress intended "inventory" to mean one thing in Section 471 and something entirely different in Section 1221(1). When faced with the question of whether securities are properly includible in inventory, courts have consistently taken the position that the standard under Section 1221(1) and Section 471

is the same. *Commissioner v. Burnet*, *supra*; *Van Suetendael v. Commissioner*, decided September 25, 1944 (P-H Memo T.C., par., 44, 305), affirmed *per curiam*, 152 F. 2d 654 (C.A. 2d, 1945); *Adnee v. Commissioner*, 41 T.C. 40 (1963); *Flarr v. Commissioner*, 44 B.T.A. 683 (1941).

The main argument of the taxpayer (Br. 41-55) is that its securities come within the last exclusion of Section 1221(1)—*i.e.* they were “held \* \* \* primarily for sale to customers” in the taxpayer’s business. As the taxpayer interprets that exclusion, the words “to customers” as applied to securities are mere surplusage since *any* sale of securities in the course of business (Br. 9) “is to ‘a customer’.” Such a skewed interpretation is possible only by disregarding the clear intention of Congress and the weight of judicial authority.

The legislative history of that particular exclusion is rather well known.<sup>3</sup> Prior to 1932, property was excluded from the definition of a capital asset if “held by the taxpayer primarily for sale in the course of his trade or business” and short-term securities losses could be offset in an unlimited amount against ordinary income. Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 101. Congress was prompted to change the law by the disclosure that some taxpayers were using securities losses generated by the depression to

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<sup>3</sup> See generally, American Law Institute, *Definitional Problems in Capital Gains Taxation*, Discussion Draft, pp. 330-331 (Oct. 20, 1960); Miller, The “Capital Asset” Concept: A Critique of Capital Gains Taxation: 1, 59 Yale L. Journal 837, 844-845 (1950); Latham, Taxation of Capital Gains, 23 Calif. L. Rev. 30, 34 (1935).

offset income from all other sources and were paying no federal income tax. In the Revenue Act of 1932, Congress singled out stocks and bonds to provide that short-term losses on the sale or exchange of stocks or bonds were deductible only to the extent of such gains. Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 23(r). That restriction applied to traders and investors but not generally to dealers in securities which were defined as:

a merchant of securities, whether an individual, partnership, or corporation, with an established place of business regularly engaged in the purchase of securities at wholesale and their resale to customers \* \* \* Traders or other taxpayers who buy and sell securities for investment or speculation, whether or not on their own account, and irrespective of whether such buying or selling constitutes the carrying on of a trade or business, are not regarded by your committee as dealers in securities \* \* \*. H. Rep. No. 708, 72d Cong., 1st Sess., p. 13 (1939-1 Cum. Bull. (Part 2) 457, 466); S. Rep. No. 665, 72d Cong., 1st Sess., p. 19 (1939-1 Cum. Bull. (Part 2) p. 496, 510), p. 19.

In the Revenue Act of 1934, Congress sought to accomplish the same result by amending the definition of capital assets so as to exclude not all property held primarily for sale in the course of business, but only such property as was held primarily for sale "to customers" in the "ordinary" course of business. Section 117, Revenue Act of 1934, c. 277, 48 Stat. 680. It was asserted that this amendment would make it "impossible to contend that a stock speculator trading



on his own account is not subject to the provisions" of the predecessor to Section 1221. H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (1939-1 Cum. Bull. (Part 2) 627, 632); Cf. S. Rep. No. 558, 73d Cong., 2d Sess., p. 12 (1939-1 Cum. Bull. (Part 2) 586, 595.

The standard explanation of the "to customers" rule in the securities area is contained in *Kemon v. Commissioner*, 16 T.C. 1026, 1032-1033 (1951):

Those who sell "to customers" are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. *This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods.* \* \* \* Such sellers are known as "dealers."

Contrasted to "dealers" are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from those to whom they sell. That is, the securities are as easily accessible to one as to the other and the seller performs no services that need be compensated for by a mark-up of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as "traders." [Italics added.]

The important point is that the term "customers" refers to a merchandising function that is performed only by a dealer. He obtains his profit or mark-up in return for services which he performs in keeping a supply of securities on hand and permitting the customer access to that supply. Whether the dealer's mark-up is in the form of commissions, fees, differentials, or price spreads, he differs from the trader who performs no such merchandising functions and who depends wholly on the rise or fall of the market for his profit. Thus, it has been held consistently that one who trades for his own account does not sell "to customers"—he is his own customer. See *e.g. Commissioner v. Burnett*, 40 B.T.A. 607 (1939), affirmed in part, 118 F. 2d 661 (C.A. 5th, 1941); *Faroll v. Jarecki*, 231 F. 2d 281 (C.A. 7th, 1956), certiorari denied, 352 U.S. 830 (1956). On the other hand, one who trades on the floor of an exchange with other professionals as a specialist does sell "to customers" for the reason that he performs a merchandising function. He is required by the rules of the exchange to maintain orderly markets in the securities he specializes in, and he is known to be ready and able to satisfy any demand for those securities within the limits of his supply. *Farr v. Commissioner*, 44 B.T.A. 683 (1941); cf. *Vaughan v. Commissioner*, 85 F. 2d 497 (C.A. 2d, 1936); *Schafer v. Helvering*, 299 U.S. 171 (1936).

Perhaps the best illustrations of the governing principle are those cases where a taxpayer in the business of buying and selling securities for customers for the customary fee decides to buy and sell for his own



account—with the prospect of profiting on the rise or fall of the market. It is well settled that these latter transactions must be separated out from the regular merchandising operation and subjected to capital asset treatment. *Van Suetendael v. Commissioner* decided September 25, 1944 (P-H Memo T.C., page 44,305), affirmed *per curiam*, 152 F. 2d 654 (C. A. 2d 1945); *Stifel, Nicholas & Co. v. Commissioner*, 1 T.C. 755 (1949); *Van Tuyl v. Commissioner*, 12 T.C. 900 (1949); *Carl Marks & Co. v. Commissioner* 12 T.C. 1196 (1949); cf. Section 1236, Internal Revenue Code of 1954.

The undisputed facts of this case establish that this taxpayer was in no position to perform any merchandising functions. Like any non-dealer, the taxpayer bought and sold securities (Br. 39) "solely for its own account." Like the ordinary taxpayer interested in the market, it bought and sold securities primarily through brokers. (R. 5, 185-C, 306.) The taxpayer was not a member of any stock exchange or registered with the S.E.C. as a broker-dealer, or even licensed to sell securities in California. (R. 128-130, 237, 282.) Accordingly, it could not accept buy and sell orders.<sup>4</sup> It could not place such order directly on any stock exchange. It could not buy or

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<sup>4</sup> The taxpayer conducts its business in California where it is incorporated. (R. 5, 65.) California law prohibits a corporation from engaging without a license in the business "of selling offering for sale, negotiating for the sale of, or otherwise dealing in, any security issued by others \* \* \* or of underwriting any issue of such securities, or of purchasing such securities with the purpose of reselling them, or of offering them for sale to the public." Corporations Code, 25 West's Annotated California Codes, Sec. 25006. See also, *id.*, Secs. 25700, 26104.

sell securities directly on the over-the-counter market,<sup>5</sup> nor could it buy or sell securities from or to the general public.<sup>6</sup>

<sup>5</sup> Unless registered with the Securities and Exchange Commission, no broker or dealer may transact interstate business on the over-the-counter markets. Securities Exchange Act of 1934, c. 404, 48 Stat. 881, Sec. 5 (15 U.S.C., 1964 ed., Sec. 78(e)), and Sec. 15, as amended by Sec. 3, Act of May 27, 1936, c. 462, 49 Stat. 1377 (15 U.S.C., 1964 ed., Sec. 78(o)). See also fn. 4, *supra*.

<sup>6</sup> The above undisputed facts based on the pleadings, admissions, answers to interrogatories, and depositions support the grant of summary judgment in favor of the Government on the capital loss issue as a matter of law. The District Court correctly so held. (R. 237, 278, 283.) The taxpayer, however, argues that a summary judgment was improper for three main reasons: (1) The affidavit in support of the Government's motion for summary judgment was inadequate (Br. 11-14); (2) Absent that affidavit, the motion should be treated as a "judgment on the pleadings" (Br. 14-15); (3) The District Court could only consider the pleadings in deciding that motion (Br. 15-35). On the contrary, the primary purpose of the summary judgment procedure is to pierce the allegations of the pleadings by other materials which establish that the movant is entitled to judgment as a matter of law. *Bushman Const. Co. v. Conner*, 307 F. 2d 888, 892 (C. A. 10th, 1962) (quoted on p. 27 of taxpayer's brief); *Burnham Chemical Co. v. Borax Consolidated, Ltd.*, 170 F. 2d 569, 573 (C. A. 9th, 1948); *Lindsey v. Leary*, 149 F. 2d 899, 902 (C. A. 9th, 1945); *Dressler v. MV Sandpiper*, 331 F. 2d 130, 132 (C. A. 2d, 1964); *St. Helena Parish School Board v. Hall*, 287 F. 2d 376, 378-379 (C. A. 5th, 1961). The presentation of information by way of affidavit on the part of the movant is permissive and not mandatory. Rule 56(c), Fed. Rul. Civ. Proc., 28 U.S.C. 56(c). In this case, the affidavit contains no material facts that are not also found in the pleadings, admissions, depositions, and answers to interrogatories. The District Court could properly consider those materials and it expressly did so. (R. 237, 278.) Finally, regardless of other facts concerning the everyday operation and activities of the taxpayer's business, the above

That the taxpayer had sizable sums of money at its disposal and engaged in activity commensurate with its funds does not make it any more a dealer in securities or any less a trader or investor. *Faroll v. Jarecki, supra*; *Kemon v. Commissioner, supra*. The taxpayer, however, relies extensively on the doctrine that profits and losses arising from the everyday operation of a business are ordinary income or losses. *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, rehearing denied, 350 U.S. 943 (1955). We have no quarrel with that doctrine except to point out that this case concerns the exception to that rule. In *Corn Products*, a manufacturer of products made from grain corn bought commodity futures as a hedge against price increases in raw materials needed in its core business of manufacturing. The Supreme Court held that the gain from the sale of those futures was ordinary income. Where by way of contrast the core "business" of the taxpayer is buying and selling futures (or similar rights) for its own account, any gain or loss is capital. *Faroll v. Jarecki, supra*; *Commissioner v. Covington*, 120 F. 2d 768 (C. A. 5th, 1941); *Commissioner v. Burnett*, 118 F. 2d 659 (C. A. 5th, 1941); *Wood v. Commissioner*, 16 T.C. 213 (1951). There is no inconsistency in the two results. Both are derived from legislative purpose. While there is a general congressional intent that everyday business profit and loss be ordinary income or loss, Congress has also created an exception to that gen-

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undisputed facts show as a matter of law that the taxpayer could not have held securities primarily for sale "to customers" within the meaning of Section 1221(1).

eral rule, as we have seen, so that any loss or gain on the sale of securities by a trader or investor is capital loss or gain.<sup>7</sup>

The taxpayer also relies on cases involving other assets, particularly real estate, for the proposition that the term "to customers" adds little to the primarily-held-for-sale provision. (Br. 41-55.) Again, we have no quarrel with that proposition as applied to other assets. It is abundantly clear from the express purpose of Congress and from subsequent judicial interpretation that the term "to customers" creates an additional requirement in the case of stock or similar rights and not, for example, in the case of real estate. The taxpayer, however, argues that the Government took the position in *Malat v. Riddel*, 383 U.S. 569 (1966) that so long as one is in business (Br. 9) "any

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<sup>7</sup> *United States v. Chinook Inv. Co.*, 136 F. 2d 984 (C. A. 9th, 1943) which the taxpayer purports to rely on (Br. 38-48) is distinguishable. In that case, this Court upheld a finding of the trial court that the taxpayer held its securities for sale "to customers" so that its securities losses were ordinary. Under the laws of the state where the taxpayer conducted its business, it appears to have been able to sell securities to the public. In considering the activities of that taxpayer, this Court concluded that the trial court was correct in finding that the taxpayer came more within the classification of dealer than either trader or investor. To the extent that some language in *Chinook* can be read as obliterating the distinction between dealer and trader and as standing for the proposition that a sale of securities by anyone engaged in the securities business is a sale "to customers", it was rejected by the Seventh Circuit in *Faroll v. Jarecki*, *supra*, p. 287, which this Court cited with approval in *Factor v. Commissioner*, 281 F. 2d 100, 120 (1960), certiorari denied, 364 U.S. 933 (1961). See also *Van Suetendael v. Commissioner*, *supra*, p. 1077. That language in *Chinook* should not be followed here.

sale is to 'a customer'." Apparently, the taxpayer gained that impression from three sentences of our *Malat* brief in the Supreme Court which it quotes (Br. 51-52.) Here is the footnote to that third sentence as it appeared in that brief (pp. 30-31):

<sup>26</sup> As pointed out *supra*, p. 14, fn. 10, the words "to customers" and "ordinary" were added to the statutory language in 1934 in order to prevent people who were actively trading in the stock market from contending that their activities were sufficient to constitute a trade or business and thus permitting them to deduct stock market losses suffered during the depression as ordinary rather than capital losses. Since stock market speculators sell a fungible item to buyers they never see, Congress believed that requiring a sale to be not merely "in the course of business" but also "to customers" would exclude them. While the original purpose of the 1934 amendment was "to prevent tax avoidance" by "a stock speculator trading on his own account," S. Rep. No. 558, 73d Cong., 2d Sess., p. 12 (1939-1 Cum. Bull. (Part 2) at 595; H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 22 (Amendment No. 66) (1939-1 Cum. Bull. (Part 2) at 632), the amendment created a permanent exception to the general rule that if a taxpayer's activities are sufficient to constitute a business his normal gains will be taxed as ordinary income. (Thus today even an active securities trader is entitled to capital gain treatment.) Therefore, in the context of a taxpayer actively engaged in the real estate business, the words "to customers" add little to the statutory requirement that the



sales be in the ordinary course of his business.  
[Citations omitted.]

Finally, it should be noted that we are here dealing with an amendment by Congress designed to reach the very type of transactions involved in this case. Added during the depression to halt a revenue loss from excessive deductions of securities losses by non-dealers, that amendment has probably operated in the intervening years to produce a net revenue loss by its preferential treatment of gains. The irony has not escaped the Internal Revenue Service.<sup>8</sup> It is doubtful that this taxpayer would have protested the classification of its securities as capital assets had their sale resulted in long-term gains. But the rule cuts both ways. The adverse consequences of that same rule can not be avoided merely because the taxpayer is now faced with losses. Perhaps the general rule that securities are capital assets to non-dealers (Br. 36) should not be the law." Nevertheless, any change should properly come from Congress.

**I. The District Court correctly held that federal stock transfer taxes paid on the purchase and sale of capital assets are not currently deductible expenses**

The taxpayer claims also that it should receive current deductions for federal stock transfer taxes it paid for 1962 on the purchase and sale of securities

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<sup>8</sup> The contention of the Internal Revenue Service, in years past, that ordinary income was generated from the profitable sale of securities or similar assets by traders met with a consistent lack of success. See *e.g.* *Kemon v. Commissioner*, 16 T.C. 1026 (1951); *Wood v. Commissioner*, 16 T.C. 213 (1951). The Commissioner of Internal Revenue acquiesced in both adverse decisions. 1951-2 Cum. Bull. pp. 3, 4.

(Br. 55-56).<sup>9</sup> The District Court correctly held that the payments were not currently deductible. (R. 243, 283.)

The only authority cited by the taxpayer is *Hirshon v. United States*, 116 F. Supp. 135, superseding, 113 F. Supp. 444 (Ct. Cl., 1953). There, the court held that a taxpayer which (as this taxpayer) was a trader in securities could deduct the federal stock transfer taxes it paid on the theory that such a tax is deductible as a business expense by one engaged in the business of buying and selling stock. In our view, the *Hirshon* theory falls short of supporting the conclusion.<sup>10</sup> Assuming that a securities trader is in the trade or business of buying and selling securities, it by no means follows that every expense of that business is deductible under Section 162 of the Internal Revenue Code of 1954. An expense of a business may be a capital expenditure, for example, and therefore not currently deductible. As this Court held in *Spangler v. Commissioner*, 323 F. 2d 913, 918 (1963), the principle that capital expenditures are not currently deductible is a "basic limitation" on deductions under Section 162.

Costs directly connected to the acquisition and disposition of capital assets are the clearest sort of capi-

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<sup>9</sup> The federal stock transfer tax provision was contained in Section 4321, Internal Revenue Code of 1954. Congress repealed that Section effective as of January 1, 1966. Excise Tax Reduction Act of 1965, P.L. 89-44, 79 Stat. 136, 148.

<sup>10</sup> The Internal Revenue Service has ruled that it will not follow *Hirshon*. Rev. Rul. 55-756, 1955-2 Cum. Bull. 536. The standard federal income tax treatise refers to *Hirshon* as a "questionable decision". 5 Mertens, Federal Income Taxation (1964 ed.), Sec. 27.20, fn. 23.



tal expenditures. *Spangler v. Commissioner, supra.*, p. 921; *United States v. Akin*, 248 F. 2d 742, 744 (C.A. 10th, 1957); *Godfrey v. Commissioner*, 335 F. 2d 82, 85 (C. A. 6th, 1964); *Willcuts v. Minnesota Tribune Co.*, 103 F. 2d 947, 950 (C. A. 8th, 1939). As we have shown, the securities in this case are capital assets. Like commissions,<sup>11</sup> a federal stock tax that is payable only if the stock is transferred can hardly be more directly connected to the acquisition and disposition of stock. Therefore, the federal stock transfer taxes in this case are capital expenditures which should be added to the basis of the securities and treated the same as the underlying asset rather than be deducted currently.

The disallowance of a current deduction to a non-dealer for the payment of federal stock transfer taxes is supported by authority. Prior to 1944, federal stock transfer taxes (stamp taxes) were deductible as taxes. See *e.g.* Revenue Act of 1938, Sec. 23(c), c. 89, 52 Stat. 447, 460, Sec. 23(c). In the Revenue Act of 1943, Congress amended that section to provide that deductions were not allowed for "Federal \* \* stamp taxes" and added the sentence "but this subsection shall not prevent such \* \* \* taxes from being deducted under subsection(a)" (the predecessor to the present Sections 162 and 212). Revenue Act of 1943, Sec. 111, c. 63, 58 Stat. 21, Sec. 111. By that amendment, Congress did not intend that such taxes could be deductible under Section 162 in all cases—

<sup>11</sup> *Helvering v. Winmill*, 305 U.S. 79 (1938); *Spreckels v. Commissioner*, 315 U.S. 488 (1942), affirming, 119 F. 2d 667 (C. A. 9th, 1941).

*e.g.*, if they were properly capital expenditures—or Congress merely provided that “*this* subsection” would not prevent taxes from being deducted under Section 162. That language cannot be fairly interpreted to mean that such taxes *shall* be deducted even though they fail to qualify as deductions under the rules normally applicable to Section 162.<sup>12</sup>

In interpreting that amendment, the Internal Revenue Service has ruled that federal stock transfer taxes are deductible only by a dealer and not by a trader or investor. I. T. 3806, 1946–2 Cum. Bull. 4; Mim. 6367, 1949–1 Cum. Bull. 63. That position has been approved by the Tax Court. *Standard Linn Service, Inc. v. Commissioner*, 33 T.C. 1 (1959); *Maytag v. Commissioner*, 32 T.C. 270 (1959); *See*

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<sup>12</sup> The legislative history of the income tax treatment of federal stock transfer taxes should be compared with recent legislative history concerning state taxes. Prior to 1964, stock transfer taxes imposed by states were deductible under Section 164(a) of the Internal Revenue Code of 1954. That section was amended by the Revenue Act of 1964 with the result that such state taxes are now deductible under Section 164 only if they are incurred in a trade or business or for the production of income. Section 207(a), Revenue Act of 1964, P.L. 88-278 Stat. 19. In contrast to the income tax treatment for federal stock transfer taxes, Congress provided that *state* stock transfer taxes which qualify under Section 164 are to be deducted currently—even though they might otherwise be capital expenditures. The Senate and House committee reports on that Act contain the identical statement that state taxes (including state stock transfer taxes) “may be deducted as taxes when they are of a business nature or for the production of income even though otherwise they might have to be capitalized”. S. Rep. No. 830, p. 55, 88th Cong., 2d Sess. (1964 Cum. Bull. (Part 2) 505, 559); H. Rep. No. 749, p. 50, 88th Cong., 1st Sess. (1964–1 Cum. Bull. (Part 2) 125, 174).

generally, 5 Mertens, Federal Income Taxation (1964 ed.), Sec. 27.20.

#### CONCLUSION

For the reasons stated, the decision of the District Court should be affirmed.

Respectfully submitted.

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NOVEMBER 1966.

#### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: \_\_\_\_\_ day of \_\_\_\_\_,  
1966.

THOMAS SILK, JR.  
*Attorney.*



## APPENDIX

### Internal Revenue Code of 1954:

#### SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General*.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 162.)

#### SEC. 164. TAXES.

(a) *General Rule*.—Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

(b) *Deduction Denied in Case of Certain Taxes*.—No deduction shall be allowed for the following taxes:

\* \* \* \* \*

(3) Federal import duties, and Federal excise and stamp taxes (not described in paragraph (1), (2), (4), or (5)); but this paragraph shall not prevent such duties and taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income).

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 164.)

#### SEC. 172. NET OPERATING LOSS DEDUCTION.

\* \* \* \* \*

(c) *Net Operating Loss Defined*.—For purposes of this section, the term “net operating loss” means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross in-

come. Such excess shall be computed with the modifications specified in subsection (d).

\* \* \* \*

(26 U.S.C. 1964 ed., Sec. 172.)

SEC. 1211. LIMITATION ON CAPITAL LOSSES.

(a) *Corporations*.—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

\* \* \* \*

(26 U.S.C. 1964 ed., Sec. 1211.)

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term “capital asset” means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

\* \* \* \*

(26 U.S.C. 1964 ed., Sec. 1221.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.471-5 *Inventories by dealers in securities.*

A dealer in securities who in his books of account regularly inventories unsold securities on hand either—

(a) At cost,

(b) At cost or market, whichever is lower, or

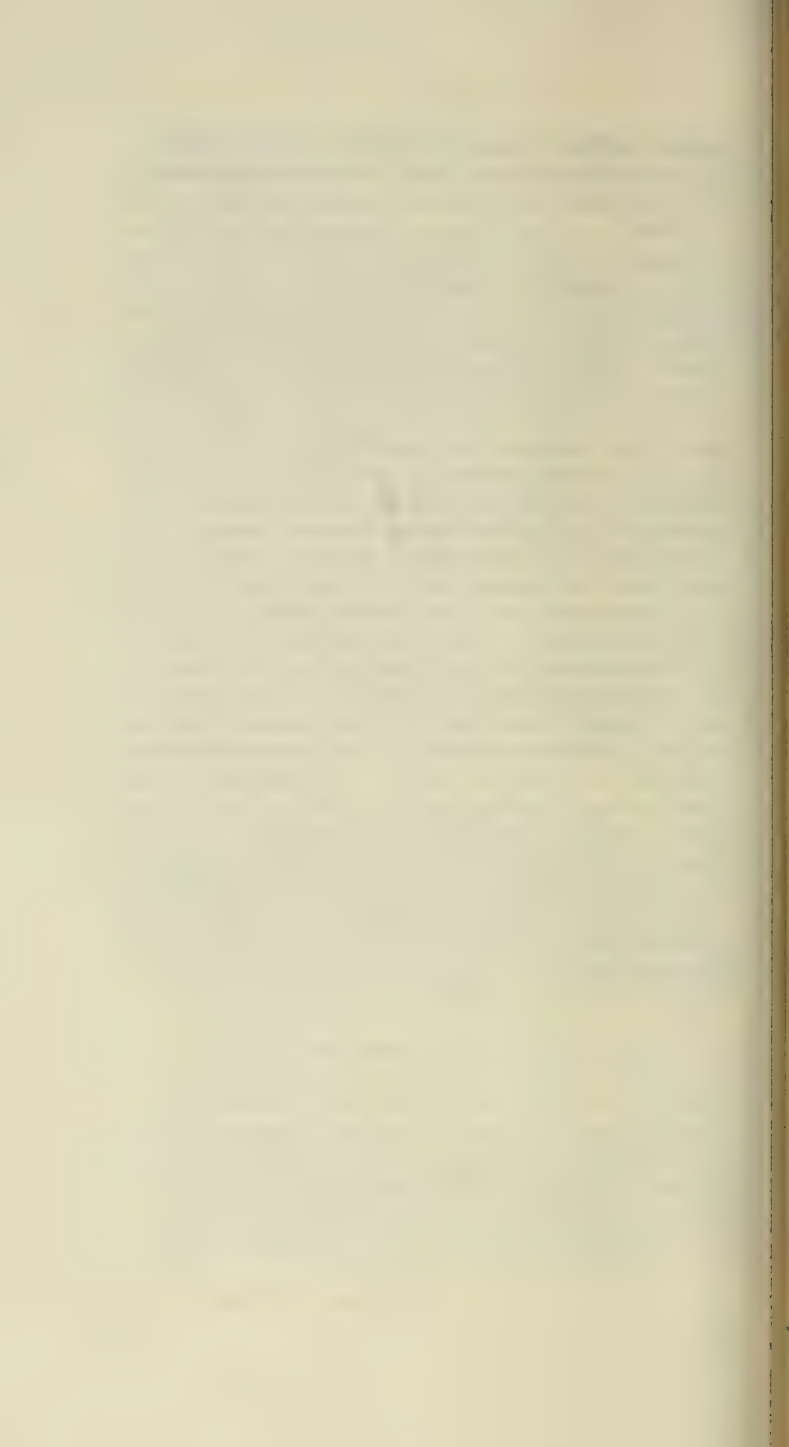
(c) At market value,

may make his return upon the basis upon which his accounts are kept, provided that a description of the method employed is included in or attached to the return, that all the securities are inventoried by the same method, and that such method is adhered to in subsequent years,

unless another method is authorized by the Commissioner pursuant to a written application therefor filed as provided in paragraph (e) of § 1.446-1. A dealer in securities in whose books of account separate computations of the gain or loss from the sale of the various lots of securities sold are made on the basis of the cost of each lot shall be regarded, for the purposes of this section, as regularly inventorying his securities at cost. For the purposes of this section, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as provided in this section may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this section.

(26 C.F.R., Sec. 1.471-5.)





Nos. 20799, 20800, 20801

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

MIRRO-DYNAMICS CORPORATION,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

On Appeal From the Judgment of the United States District  
Court for the Southern District of California.

---

## APPELLANT'S REPLY BRIEF.

---

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Nos. 20799, 20800, 20801

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## APPELLANT'S REPLY BRIEF.

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The Government, without conceding the insufficiency of Asst. U. S. Attorney Greenwald's affidavit, takes the position (Govt. Br. 15) in a footnote that the affidavit is merely surplusage, as the material there set forth is found in the pleadings, admissions, depositions, and answers to interrogatories. Appellant's brief (p. 33) shows the deletions in the so-called "undisputed facts" set forth in the lower court's Decision and what would remain if the source and support thereof were limited to the pleadings, admissions, and answers to interrogatories.

Based on the immaterial residuum, there is no doubt that there are triable issues of fact and summary judgment was improvidently granted. In fact the bulk of the facts comprising the Government's Statement of Facts (p. 2) are culled from the claims for refund appended to the complaints as Exhibit A, although the Government in its Answers "denies all allegations of fact and conclusions of law contained in Ex. A not otherwise expressly admitted." [R. 114, 330, 361]. Other than jurisdictional allegations, very little was expressly admitted in these Answers. As a result the claims for refund [R. 5] do not support the facts in the Government's Statement. In addition the references to the admissions [R. 71-72] do not support the facts there set forth.

The lower court did NOT have before it

(1) the corporate purposes in the Articles of Incorporation; or

(2) any corporate minutes; or

(3) any evidence of intent on the part of plaintiff in the everyday operation of its business; or

(4) the scope and ambit of plaintiff's activities, except for the facts which the Government requested the plaintiff to admit concerning its brokerage accounts and whether it belonged to various organizations; or

(5) the information necessary to determine the correct amount of income and deductions from which the correct tax could be computed.



### The Government Has Not Rebutted the Foregoing.

Apparently the gist of the Government's argument (pp. 14-15) is that plaintiff could prevail only if it had customers and that since it was not a member of any stock exchange or registered with the SEC as a broker-dealer or licensed to sell securities in California, it must have had no customers as a matter of fact. Without conceding the validity of this premise, Appellant cannot believe that the Government is now urging that tax consequences turn on what a taxpayer can legally do rather than on what a taxpayer intended to do and actually did do. There was nothing before the lower court as to the taxpayer's intent in this connection. In response to Government requests for admissions, plaintiff did admit that it "did not acquire orders or funds from private investors" for securities and that it "did not sell or authorize the sale" of securities for private investors [R. 129]. This merely means that it did not conduct a brokerage business. There has never been any contention that plaintiff was a broker.

The lower court apparently found [R. 282] that the stock transactions were solely for plaintiff's account, which is correct since the plaintiff was not, and did not purport to be, a broker acting as an agent rather than a principal. Whether a taxpayer buys or sells a security as a principal, for his own account, is totally irrelevant and immaterial to the determination of whether capital gain or ordinary income results. A taxpayer who is allowed to inventory securities as a dealer as defined in U.S. Treas. Reg. §1.471-5 purchases securities for his own account to be held in inventory. When he sells securities from his inventory, he is then selling as a principal for his own account. The

SEC definition of dealer (Appt. Br. 38) so provides. Ethically he is required to sell such a security at a net price without any commission, since he is acting as a principal and not as a broker who would charge a commission for acting as an agent. A broker ordinarily derives his income from commissions generated by his activities as an agent, resulting in ordinary income.

A §471-5 dealer's activities also yield ordinary income with respect to his inventory of securities, as they are excluded from capital assets because they are stock in trade. It is not, as the Government urges (p. 12-3), because it is in return for services which he performs in keeping a supply of securities on hand and permitting another principal or broker access to that supply.

There is no doubt that the Government is confusing brokers with dealers. To the extent that stocks rise in price during the time that they are owned by the §471-5 dealer, his profit contains an element of gain other than remuneration for his labors in carrying on his brokerage activities, and his losses reflect the risk of loss which he bore in exactly the same manner as the taxpayer in this case. Without doubt, one of the economic functions of an owner of assets is to bear the depreciation or benefit from the appreciation of those assets. This function cannot be separated from the ownership of such assets.

If a §471-5 dealer had the misfortune to spend the whole year buying high and selling low as did this taxpayer, would the Government contend that because the loss resulted from a decline in the value of the securities the dealer bought and sold day by day, it was not an operating loss?

When a corporation chooses to engage in the business of buying and selling assets, it is putting its capital at the risk of the market in the assets. If the price rises, the corporation is rewarded for taking that risk by its profit on those assets, and this income which it generates from its day to day operations in buying and selling those assets is ordinary income, whether the assets consist of guns, butter, diamonds or securities. Similarly if the price falls, the corporation incurs a loss which no one will deny is an ordinary loss in the case of a corporation which buys and sells guns, butter or diamonds—and it follows that if a corporation generates ordinary loss from its daily activities in buying and selling guns, butter or diamonds, it would have ordinary loss from its daily activities in buying and selling stocks.

This is the rule of *United States v. Chinook Inv. Co.*, 136 F. 2d 984 (9th Cir. 1943), which this Court has never overruled. In addition, this opinion squarely rejects the Government's contention that only a §471 dealer's activities generate ordinary income and loss. In that case this Court specifically rejected the Government's contention here (p. 9) that "courts have *consistently* taken the position that the standard under §1221(1) and §471 is the same." (Ital. added). In fact, the only appellate opinion cited for this contention, *Com'r v. Burnett*, 118 F. 2d 661 (5th Cir. 1941) (erroneously cited as *Burnet*, 10th Cir. at Govt. Br. 9), this Court refused to follow in *Chinook Inv. Co.*, *supra* at 985.

Thus, this Court considers immaterial and irrelevant the criterion adopted by the Regulations as to whether

a taxpayer is a merchant of securities in determining whether there is a trade or business with sales to customers. It is submitted that the language cited from *G. R. Kemon*, 16 T. C. 1026 (Govt. Br. 12), which the Government characterizes as a "standard explanation" is not a correct one, except insofar as it paraphrases the Regulation's definition of dealer, which by its terms is limited to inventory determinations. The only statutory definition of dealer is contained in the Securities Exchange Act of 1934, 15 U.S.C.A. §78c-(a)(5) and provides that a dealer "means a person engaged in the business of buying and selling securities *for his own account*, through a broker or otherwise. . . ." (Ital. added). Under this definition if the taxpayer were afforded its day in court, it may be able to prove that it was a dealer. **However, the pertinent provisions of the Internal Revenue Code do not turn on whether the taxpayer is a dealer.** The determination of whether plaintiff is entitled to carry back its operating losses turns on whether ordinary losses were generated from its business of buying and selling securities.

Although Appellant set forth the legislative history behind §1221(1) in a spirit of providing the Court with all points and authorities, it is submitted that it is irrelevant and immaterial.

"Recourse may be had to legislative history of an act of Congress only where the words are ambiguous or would bring about an end completely at variance with the purpose of the statute if literally construed." *Gilbert v. Com'r*, 241 F. 2d 491, 494 (9th Cir. 1957).

The Supreme Court in *Malat v. Riddell*, 383 U.S. 569 (1966) felt that resort to the legislative history of §1221(1) was not necessary as revenue acts “should be interpreted where possible in their ordinary everyday senses.” In *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 89 (1935), the Court held that it was “not at liberty to construe language so plain as to need no construction, or to refer to committee reports where there can be no doubt of the meaning of the words used.” Where a statute is unambiguous, a court should not “utilize legislative history to create an ambiguity.” *Flex-O-Glass, Inc. v. United States*, 3 A.F.T.R. 2d 1034, 1037 (N.D. Ill. 1959).

“It is elementary in the law of statutory construction that, absent ambiguity or an absurd or unreasonable result, the literal language of a statute controls and resort to legislative history is not only unnecessary but improper.” *Elm City Broadcasting Corp. v. United States*, 235 F. 2d 811, 816 (D.C. Cir. 1956).

References to Congressional records or statements of legislators “may never be used to create doubt.” *Un. Elec. Coal Cos. v. Rice*, 80 F. 2d 1, 8 (7th Cir. 1935), cert. denied 297 U.S. 714.

Accordingly, the decisions of this Court compel the conclusion that §1221(1) does not allow for differences in interpretation as to the business or assets involved, whether real property or securities, and that if a taxpayer is in a trade or business and the only manner in which benefit is to be realized from the property is ultimate sale at a profit, then the acquisition and holding must be considered for sale to customers in the ordinary course of business. (*Chinook Inv. Co.*, 136 F. 2d

984; *Ehrman*, 120 F. 2d 482, 485, cert. denied 314 U.S. 668; *Margolis*, 337 F. 2d 1001, 1004, reh. 339 F. 2d 357.)

In light of the decisions of this Circuit and the recent Supreme Court decisions (App't Br. 17), upon which the Government does not comment, there is no doubt that the authorities on which the Government relies do not withstand scrutiny and are no longer vital, as §1221(1) is in no sense of the word ambiguous and the legislative history cannot be used to tailor the statute to the facts of this case by interpreting it in different ways for real property as distinguished from securities, where the statute *is* general in its applicability.

Respectfully submitted,

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### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

ROBERT H. WYSHAK





No. 20,807 ✓

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,

*Appellant,*

VS.

UNITED STATES OF AMERICA,

*Appellee.*

APPELLANT'S OPENING BRIEF

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No. 20,807

**United States Court of Appeals  
For the Ninth Circuit**

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LESLEY COHEN,	}
vs.	
UNITED STATES OF AMERICA,	
	<i>Appellant,</i>
	<i>Appellee.</i>

---

**APPELLANT'S OPENING BRIEF**

---

**JURISDICTION**

Jurisdiction is invoked under Section 1084 of Title 18 of United States Code and Sections 1291 and 1294(1) of Title 28 of United States Code.

---

**STATEMENT OF THE CASE**

Appellant was indicted on September 11, 1963, and charged with nine counts of violation of Section 1084 of Title 18 of the United States Code for the transmission of illegal wagers and betting information over an interstate telephone. TR 6. Appellant moved to suppress under Rule 41 on the grounds that evidence was secured against him in violation of the Constitution by an examination of his mail and by the inter-

ception of his telephone calls. TR 13, 57 and 58. Appellant also moved to dismiss the indictment on the grounds of duplicity and that motion was denied by the Court on May 8, 1964. TR 37.

A Bill of Particulars and an Amended Bill of Particulars were filed by the Government on February 7, 1964, and February 27, 1964. TR 31, 34. The Government filed certain Affidavits denying tampering with the defendant's mail or tapping his telephone and counsel for the appellant filed the following Affidavit.

*“Richard H. Foster, being first duly sworn, deposes and says:*

*“1. That he is one of the attorneys representing the defendant, Les Cohen, and is familiar with the files, records, facts and circumstances surrounding the case.*

*“2. That on April 22, 1963, the firm of Lewis & Foster mailed to the defendant, Les Cohen, a letter containing confidential legal advice and this letter presumedlly was intercepted by agents of the Internal Revenue Service in connection with the investigation of this defendant.*

*“3. That in connection with his investigation of this case, your affiant interviewed numerous individuals who had been interviewed by agents of the Internal Revenue Service. The individuals interviewed were asked questions by the agents of the Internal Revenue Service concerning correspondence and telephone calls made to the defendant, Les Cohen. The content of these questions was such that in order to ask the questions, the Internal Revenue Service agents must have*

been familiar with the content of the correspondence and with the content of the telephone conversations to which the questions referred.

Richard H. Foster.”

On April 21, 1965, the Court denied appellant's Motion to Suppress without taking testimony on the grounds that the Government's *affidavits* indicated that no tapping was made of defendant's wire and appellant's mail was not obstructed. It is to be noted that in the Motion to Suppress it is alleged that the Government not only opened and examined first class mail of the appellant, but also delayed and obstructed the mail in violation of the statutes mentioned in the Motion. The Government admitted a “so-called mail watch” which they did not consider violated the postal statute. The Court, apparently, agreed to the conclusions established by affidavit filed by the United States Attorney and the postal authorities.

At the trial, and prior to the denial of the hearing on the Motion to Suppress, witnesses were subpoenaed by the defense, including postal employees, F.B.I. agents, and officials of the Nevada Telephone Company. Both on the Motion to Suppress Evidence and at the trial, appellant was foreclosed from inquiring into either mail tampering or wire tapping by examining these witnesses.

Appellant was an employee of the Saratoga Race Sports Book, a legal “bookie” establishment in Las Vegas, Nevada. He and the witness Schuman, upon whom the conviction ultimately rested, were social acquaintances of thirty years standing.

At the trial, the Government introduced proof which tended to show that only two bettors were involved in the nine counts of the indictment, Raymond Syufy and Adolph Schuman. Three other witnesses testified as to bets and conversations concerning betting with the defendant, but these witnesses, Hochfeld, Drossman and Stead, were introduced only as common plan, scheme or design witnesses and they testified for the most part to conversations occurring prior to the effective date of Section 1084. The witness Stead's testimony was stricken in its entirety by the Court. Appellant was acquitted by either the jury or the Court on all counts except Count 7 and Count 9. Count 7, according to the Bill of Particulars, involved both Syufy and Schuman,

“By Adolph P. Schuman by calling on three to five times to Las Vegas, Nevada, to secure the line or odds on the San Francisco Forty-Niners football games during this period of time. By Raymond Syufy actually placing bets on one-half of the San Francisco Forty-Niners (sic) during the period in question, and by Raymond Syufy actually placing bets with the defendant on one-half (not more than seven nor less than six) of all San Francisco Forty-Niners football games played during this period of time.” TR 38

Count 9 involved a bet on the Liston-Patterson heavyweight fight. The witness Syufy could not identify the appellant as the individual with whom he made wagers over the telephone. The witness Schuman at one time at least stated he could not swear as to his

location at the time he made the bet on the Liston-Patterson fight over the telephone. TR 209.

The Court upheld the conviction on a Motion for Judgment of Acquittal and for a New Trial on the basis that in the Court's opinion a "conscious disregard" by not ascertaining the place from where the bettor called was sufficient to justify conviction in spite of the lack of any evidence indicating appellant's knowledge of the location of the bettor. TR 5 Hearing of November 30, 1965. The Court then sentenced the defendant to pay a fine in the sum of \$5,000.00, stating during the course of his sentencing that the appellant was not "connected with any sinister ring or syndicate or operation", that the appellant came from a good family and conducted himself within the field of gambling "in a very upright manner." Hearing of November 30, 1965. Appeal was then timely made to this Court.

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#### STATUTES INVOLVED

Section 1084 of Title 18 of the U.S. Code provides:

§1084. *Transmission of wagering information; penalties*

“(a) Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which

entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined not more than \$10,000 or imprisoned not more than two years, or both.

(b) Nothing in this section shall be construed to prevent the transmission in interstate or foreign commerce of information for use in news reporting of sporting events or contests, or for the transmission of information assisting in the placing of bets or wagers on a sporting event or contest from a State where betting on that sporting event or contest is legal into a State in which such betting is legal.

(c) Nothing contained in this section shall create immunity from criminal prosecution under any laws of any State, Commonwealth of Puerto Rico, territory, possession, or the District of Columbia.

(d) When any common carrier, subject to the jurisdiction of the Federal Communications Commission is notified in writing by a Federal, State, or local law enforcement agency, acting within its jurisdiction, that any facility furnished by it is being used or will be used for the purpose of transmitting or receiving gambling information in interstate or foreign commerce in violation of Federal, State or local law, it shall discontinue or refuse, the leasing, furnishing, or maintaining of such facility, after reasonable notice to the subscriber, but no damages, penalty or forfeiture, civil or criminal, shall be found against any common carrier for any act done in compliance with any notice received from a law enforcement agency. Nothing in this section shall be deemed



to prejudice the right of any person affected thereby to secure an appropriate determination, as otherwise provided by law, in a Federal court or in a State or local tribunal or agency, that such facility should not be discontinued or removed, or should be restored. Added Pub.L. 87-216, §2, Sept. 13, 1961, 75 Stat. 491."

26 USC 4401 provides:

Sec. 4401 *Imposition of Tax.*

“(a) Wagers.—There shall be imposed on wagers, as defined in section 4421, an excise tax equal to 10 percent of the amount thereof.

(b) Amount of Wager.—In determining the amount of any wager for the purposes of this subchapter, all charges incident to the placing of such wager shall be included; except that if the taxpayer establishes, in accordance with regulations prescribed by the Secretary or his delegate, that an amount equal to the tax imposed by this subchapter has been collected as a separate charge from the person placing such wager, the amount so collected shall be excluded.

(c) Persons Liable for Tax.—Each person who is engaged in the business of accepting wagers shall be liable for and shall pay the tax under this subchapter on all wagers placed with him. Each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax under this subchapter on all wagers placed in such pool or lottery. Any person required to register under section 4412 who receives wagers for or on behalf of another person without having registered under section 4412 the name and place of residence of such other person shall be liable



for and shall pay the tax under this subchapter on all such wagers received by him.”

26 USC 4411 provides:

Sec. 4411. *Imposition of Tax.*

“There shall be imposed a special tax of \$50 per year to be paid by each person who is liable for tax under section 4401 or who is engaged in receiving wagers for or on behalf of any person so liable.”

26 USC 4412(a) provides:

Sec. 4412. *Registration.*

“(a) Requirement. Each person required to pay a special tax under this subchapter shall register with the official in charge of the internal revenue district—

(1) his name and place of residence;

(2) if he is liable for tax under subchapter A, each place of business where the activity which makes him so liable is carried on, and the name and place of residence of each person who is engaged in receiving wagers for him or on his behalf; and

(3) if he is engaged in receiving wagers for or on behalf of any person liable for tax under subchapter A, the name and place of residence of each such person.”

Sections 1700, 1701, 1702 and 1703 of Title 18 of the U.S. code provide as follows:

§1700. *Desertion of mails.*

“Whoever, having taken charge of any mail, voluntarily quits or deserts the same before he

has delivered it into the post office at the termination of the route, or to some known mail carrier, messenger, agent, or other employee in the Postal Service authorized to receive the same, shall be fined not more than \$500 or imprisoned not more than one year, or both."

§1701. *Obstruction of mails generally*

"Whoever knowingly and willfully obstructs or retards the passage of the mail, or any carrier or conveyance carrying the mail, shall be fined not more than \$100 or imprisoned not more than six months, or both."

§1702. *Obstruction of correspondence.*

"Whoever takes any letter, postal card, or package out of any post office or any authorized depository for mail matter, or from any letter or mail carrier, or which has been in any post office or authorized depository, or in the custody of any letter or mail carrier, before it has been delivered to the person to whom it was directed, with design to obstruct the correspondence, or to pry into the business or secrets of another, or opens, secretes, embezzles, or destroys the same, shall be fined not more than \$2,000 or imprisoned not more than five years, or both."

§1703. *Delay or destruction of mail or newspapers*

"(a) Whoever, being a postmaster or Postal Service employee, unlawfully detains, delays, or opens any letter, postal card, package, bag or mail intrusted to him or which shall come into his possession, and which was intended to be conveyed by mail, or carried or delivered by any

carrier or other employee of the Postal Service, or forwarded through or delivered from any post office or station thereof established by authority of the Postmaster General; or secretes, or destroys any such letter, postal card, package, bag, or mail, shall be fined not more than \$500 or imprisoned not more than five years, or both.

“(b) Whoever, being a postmaster or Postal Service employee, improperly detains, delays, or destroys any newspaper, or permits any other person to detain, delay, or destroy the same, or opens, or permits any other person to open, any mail or package of newspapers not directed to the office where he is employed; or

Whoever, without authority, opens, or destroys any mail or package of newspapers not directed to him, shall be fined not more than \$100 or imprisoned not more than one year or both. As amended May 24, 1949, c. 139, § 37, 63 Stat. 95.”

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### REGULATIONS INVOLVED

Regulation 44.4401-2(b) provides:

“(b) *In Business of accepting wagers.*

“A person is engaged in the business of accepting wagers if he makes it a practice to accept wagers with respect to which he assumes the risk of profit or loss depending upon the outcome of the event or the contest with respect to which the wager is accepted.”

### **SPECIFICATIONS OF ERROR**

1. The evidence was insufficient.
2. The Motion to Suppress was improperly denied without a hearing.
3. The evidence was insufficient to prove knowledge of the interstate character of the call.
4. The Court's instruction on intent was improper.
5. Failure to instruct on social wagers was improper.
6. The Court's instruction on the business of wagering was improper.
7. The Court's instruction on "ignorance of the law" was improper.
8. Appellant was deprived of a fair trial by an undue limitation on cross-examination of the witness Schuman.
9. The conviction on Count 7 was improper since this count of the indictment was duplicitous.
10. The introduction of testimony tending to show other offenses than those shown in the indictment was prejudicial.

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### **QUESTIONS PRESENTED**

1. Can a Court deny without a hearing a Motion to Suppress based upon mail tampering on the affidavits of Government officials?
2. Must there be evidence, directly or indirectly, proving knowledge of the location of the better to constitute a violation of 18 U.S.C. 1084?

3. May a conviction rest on the testimony of a witness who cannot swear to an essential element of the defense?

4. In a Section 1084 prosecution is it proper to give the instruction that it may be inferred that a person intends the natural and probable consequences of his acts?

5. In a Section 1084 prosecution should there be an instruction where the evidence warrants on "social wagers?"

6. Are the requirements of Section 1084 with respect to be "in the business of wagering" the same as the requirements in the wagering tax law with respect to the business of accepting wagers?

7. Was it proper to instruct on "ignorance of the law"?

8. Was cross-examination improperly limited?

9. Is Count 7 of the indictment duplicitous?

10. Is the introduction of evidence tending to show the commission of other offenses prejudicial error?

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## ARGUMENT

### I. THE COURT ERRED IN DENYING THE MOTION TO SUPPRESS WITHOUT A HEARING.

#### A. Obstructing Appellant's Mail Is Unconstitutional and Con- trary to Statute.

The instant case involves probably the most important procedural issue currently within the field of the criminal law. The slow and steady encroachment of the Federal Government into the privacy of its

citizen reaches its culmination in the cynical assertion on the part of the United States Attorney's office, confirmed by the Court below, that no question can or should be raised into their interception of private, first class mail addressed to the appellant herein and the novel and strange assertion by them that a bland statement by them denying misconduct forecloses any judicial inquiry into the extent of their mail tampering or whether or not in fact, agents of the government tapped the wires of appellant.

The Post Office is the agent of the public, not of the Internal Revenue Service, *Cumford v. Thompson*, 1 Fed. 417. In the instant case persons desiring to correspond with the appellant deposited with the agents of the public and of them, that is to say the Post Office Department, mail intended not for the information of the Internal Revenue Service, but mail intended for the recipient alone. They admit this mail was examined and the results of the examination submitted to the Internal Revenue Service for the purpose of prying into the business secrets of the appellant, in brief, the Internal Revenue Service desired to gain information concerning the appellant's gambling activities, if any. No authorization for such an examination was indicated by the Government. The assertion was simply made that the Government through the Post Office Department has the unqualified right to examine and record information on mail so long as the mail is not opened.

The importance of the problems presented in this attempt by the Government to encroach into the secrecy of the mail is emphasized by the hearings of



Senator Edward V. Long, D(MO) of the judicial committee inquiring into the encroachment by this practice of the right of privacy. Senator Long has introduced a bill, S2627, to specifically prohibit the practice present here.

In the instant case an additional factor is presented as was presented in the Roy Cohen case, that is to say, mail was intercepted by the Government from appellant's attorney. We suggested that this creates additional constitutional problems, *Messiah v. US*, 377 US 201.

The Government takes the position that intercepting and examining mail is a proper practice until the mail is opened. We think it is clear under the statutes and the cases, that the contrary is true. Section 1702 of Title 18 provides in part: “. . .whoever takes a letter before it has been delivered to the person to whom it has been directed, with a design to obstruct the correspondence or pry into the business secrets of another . . .” is guilty of an offense. It is clear from this section, opening mail is not the only offense which would justify a motion such as was made here. Section 1701 provides that whoever “. . . obstructs or retards the passage of mail . . .” is guilty of an offense. Section 1703 provides an offense where the postmaster “detains or delays” mail. To be sure, opening mail is an offense but as the Court can see from the above sections, it is not the only offense involving the interception of mail.

There is some authority for the Government's contentions, *Costello v. USA*, 255 Fed. 876. However, the



*Costello* case is based on a petition for rehearing, not a motion to suppress as here. At any event, this authority is not binding in any circumstances since it is not a decision in this circuit.

In our opinion, previous decisions in the Supreme Court forbid even the practice the Government concedes that it engages in. As early as 1877, the Supreme Court in *Ex parte Jackson* stated "letters and sealed pages . . . are as fully guaranteed from examination and inspection . . . as they were retained by the parties forwarding them in their own domicile." *Ex parte Jackson*, 96 US 727. As the Court indicated in *Hoover v. McChesney*, 81 Fed. 472, the examination of mail is an unreasonable search and seizure, unless the Government has a search warrant.

Prior to *Costello*, the holdings of the courts were that the Post Office Department could not interfere with mail unless there was some warrant in statutory authority. In *American Schools v. McNulty*, 187 US 921, the principle was established that the postal authorities may not "exercise jurisdiction in a case not governed by statute." This case held that the use of the mail was a constitutional right (see also *Pike v. Walker*, 121 Fed. 2d 37). In the event that the mail is not used properly according to the cases, the postal authorities had only the right as authorized by statutes to tamper with the mail after an administration hearing. The only exception to this rule is the right to resort to a search warrant as indicated in *Hoover v. McChesney*, *supra*. See also, *Walker v. Popenoe*, 149 Fed. 2d 511. Where no authority was granted by

statute even though the practices involved are nefarious, no authority lies in the Post Office Department to tamper with the mail. *US v. Halseth*, 342 US 247.

It should be noted that there is no statutory authority which in any way indicates that the letters intercepted here were non-mailable. Sections 4005, 4006, 4007 and 4008 define the occasions where mail can be intercepted and seized. Nowhere is a bookie in any way embraced within the statutes.

In the present case there is no warrant in either statute or regulations for the examination of the appellant's mail. The postal department is not the agent of the Internal Revenue Service, it is the agent of those using the mail. If Congress desired that upon the application of the proper agency of the Government mail could be examined, they would have passed a statute to that effect. No such statute was passed. *American Schools v. McNulty*, *supra*, therefore applies and there is no jurisdiction in the postal department to examine appellant's mail for the purpose of obtaining evidence against him without a search warrant.

We believe that the above conclusion has been upheld by this Court in the *Heilberg v. Fixa* case (affirmed *Fixa v. Heilberg*, 33 LW 4489). There the Court indicated that freedom of speech and the right of privacy preclude the interrogation of persons receiving "communist political propaganda." Here an individual engaged in lawful business has a right to correspond with those persons he so desires, including

his attorney. There is no warrant in the statutes and in fact, it would appear to be unconstitutional to subject his correspondents to interrogation by agencies of the Government.

Persons have a right to correspond with legal gamblers in Las Vegas just as they have a right to correspond with Communists. It would appear that there should be no greater constitutional right in the one case than in the other. The Court may not approve of gamblers but they are however, citizens and they have a right to correspond so long as they conduct themselves in accordance with the law.

In the event that they do not, the normal remedy of a search warrant is available to the Government. It would appear that a search into their mail should be conducted according to normal principles of law appropriate to searches. The Post Office Department is an agent of the public, not of the Internal Revenue Service and the right of privacy involved in communicating by mail should be as extensive as that guaranteed by the Federal Communications Act with respect to the telephone. Since the decision of the Court below, the Supreme Court affirmed *Fixa v. Heilberg*, at 33 LW 4489 referred to above.

The Supreme Court declared a statute expressly giving authority for the examination of mail unconstitutional. It should be noted that here there is neither a statute or regulation expressly authorizing such a procedure. The Supreme Court stated "The Act sets administrative officials astride the flow of mail to inspect it, appraise it, write the addressee

about it, and await a response before dispatching the mail." Here instead of an Act clothed with the authority of the Congress, the unfettered, unauthorized act of Internal Revenue employees sets post office officials astride the flow of mail to inspect, appraise and obstruct it. Instead of an invitation to write about it, the addressees and addressors are actually interviewed. The odium of association with a Communist is no less than the odium of association with legal gamblers. In the event that it is considered desirable to monitor specific classes of citizens' mail, we suggest that Congress is the only authority which has the right to make that decision if any right constitutionally exists. The breaching of the principle of the inviolability of the mail as an investigative tool is the ultimate in the slow retreat from the concept of individual liberty.

#### **B. A Hearing Should Have Been Held.**

The Government claims that no hearing need be held to determine the facts surrounding the interception of the appellant's mail and the interception of his telephone conversations. We believe that in this circuit the rules require an oral hearing and the taking of evidence. In the case of *Hoffritz v. US* (9 Cir.) 240 Fed. 2d 109, the Court held that if an issue of fact is raised an oral hearing must be held. As the Court stated in *Austin v. USA*, 297 Fed. 2d 356, "unless his allegations clearly show that even if true, he would be entitled to no relief. He would be entitled to a hearing." Here the allegations of the motion are actually based upon statutes of the United States.

In the motion we, so to speak, indicted the Government. Each allegation charges a violation of the statute of the United States mentioned in the paragraph. The Government's bland denial of misconduct serves only to raise the issue of fact and requires a hearing in this case.

Here an affidavit was filed indicating the grounds for believing the appellant's conversations and correspondence to be intercepted. Unless Government officials expressly admit eavesdropping into the telephone conversations and mail correspondence of a defendant, there can never be stronger allegations.

In Rule 41 Proceedings, a defendant has no right to take depositions. Only by an oral hearing before the Court may a defendant in this proceeding obtain compulsory process for the obtaining of witnesses. Here alone, the defendant may have the compulsory process for the obtaining of witnesses guaranteed by the Constitution which will establish the grounds for his motion. The foreclosure of judicial inquiry by a bland denial by the United States Attorney or the Government employees involved by affidavit would seem to us to be unconstitutional, as well as bad judicial procedure. A defendant should have the right to examine and cross-examine Government officials under oath, otherwise any meaningful inquiry into misconduct of Government officials resulting in the deprivation of constitutional rights would be impossible.

An inquiry going behind the affidavits filed by the Government could have established much more in the way of an examination than admitted by the Govern-



ment. An examination of mail, even without opening it, can reveal the contents thereof. Placing the mail before a strong light often will allow the contents to be read. Whereas, here the Government expressly admits mail tampering, judicial inquiry should not be foreclosed to determine under the conditions of a judicial examination how far the Government has in fact gone.

The Court will note that at the trial the defense was foreclosed from inquiring into the extent that the witnesses were secured and influenced by the Government's mail tampering. It appears clear that all or practically all of the witnesses were secured by the use of this investigating tool or by the use of wire tapping. In particular the witness Schuman, on which the conviction ultimately rests, was not the type of individual who would ordinarily be contacted by investigative agencies with respect to an employee of a legal gambling establishment in Las Vegas. The only contacts which could have identified him with appellant were the examination of his mail or the tapping of the appellant's telephone conversations.

We have not discussed in detail the principle regarding the allegation of wire tapping because the principles are clear and well established. Wire tapping was alleged and supported by affidavit. An issue of fact was raised and the hearing should have been held to determine the facts as they actually exist. It should be noted that FBI officials and officials of the telephone company of Nevada were subpoenaed by the defense to try and establish the fact of wire tapping.

Both a hearing on the motion to suppress was denied and inquiry at the trial was denied. This we submit is fundamental, reversible error.

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## II. THE EVIDENCE WAS INSUFFICIENT TO "PROVE THE KNOWLEDGE" REQUIRED BY THE STATUTES.

An essential element of the Government's proof in this case was to prove the knowledge of the defendant of the interstate character of the calls. None of the witnesses who testified in the case gave any testimony which directly or indirectly would establish this fact. In no case did the witnesses inform the defendant of their location after the effective date of Section 1084 of Title 18. None of the calls were of such a character that telephone officials would have given some indication that long distance was involved. All of the witnesses were frequent visitors to Las Vegas. Appellant here was an employee of a legal wagering business in Las Vegas and legitimately could handle hundreds or even thousands of telephone calls concerning the subject of betting on the telephone within the State of Nevada.

The difficulties of the prosecution establishing a valid conviction on this kind of evidence were commented on by the Court in connection with the motions made at the conclusion of the Government's case:

"The Court: But on that same circumstance, on that exact same evidence, number one, I have to make the same implication that he was talking on the telephone, that he knew where the calls came from. You have about three things here,



three ultimates that you have got to assume, that is, by implication, reasonable implication, one upon the other, don't you?

You know, there is an old doctrine that you cannot put an inference on an inference and implications on implications. Don't we have to do that very thing. Don't we have to take two or three steps, which each one has an inference to be drawn from the others of the one original step?" TR 504.

With respect to the witness Syufy, almost every element required to be proved was conspicuous by its absence. With the exception of one football game, the San Francisco Forty-Niners versus the Cleveland Browns (Count 8), Mr. Syufy was unable to remember his location. Furthermore, he was unable to identify the defendant. In fact, his testimony, since he indicated three voices were involved, definitely establishes that it could not have been the defendant on at least some occasions. Furthermore, there was no testimony supplied by the witness from which an inference could be drawn that the defendant knew the place from which he was calling.

As the Court observed at page 476 of the transcript "Maybe when we analyze the Schuman testimony it is weaker than the Syufy testimony" and at page 451 "The only thing here is, Mr. Schuman's testimony in particular was all entangled. I mean, he was giving the odds on his memory. One place it was 99 to 1, another place it was complete. Another place it wasn't quite 99 to 1. This is speculation." The evidence establishes a very close social relationship between the par-

ties. As the Court observed, there was considerable doubt whether the bets were seriously meant at all. See pages 491 to 496 of the transcript.

There is a complete lack of any evidence here from which the jury could conclude beyond a reasonable doubt that Mr. Cohen *knew* from where Mr. Schuman was calling. Nothing in the conversations indicated the place from which the call was placed either directly or indirectly. No conversation subsequent to the bet indicated any knowledge on Mr. Cohen's part of the location of the call. The Trial Court's statement of the old rule of the impropriety of piling inference on inference simply characterizes the situation where there is a complete lack of proof as to the defendant's knowledge of the illegal character of the call. Any finding of a jury of knowledge on Mr. Cohen's part would be pure speculation.

In trying to justify a finding of guilty by the jury on a motion for a new trial, the most that the Court could find to prove the fact of knowledge of the interstate character of the call was a statement that the appellant somehow "consciously disregarded" where the call was made from. TR 5 Hearing of November 30, 1965. This, apparently was established because appellant did not inquire as to where the calls originated. We submit, under the circumstances, that there is no duty of inquiry in a case of this character. The law does not provide that an individual working in a legal gambling establishment must affirmatively establish innocence with respect to a telephone call. On the contrary, we believe the burden is still on the Govern-

ment to prove that he had, in fact, the guilty knowledge required by the statute. Even a gambler need not answer a telephone at his peril.

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### III. THE EVIDENCE WAS INSUFFICIENT IN MANY OTHER RESPECTS.

The evidence in this case was unsatisfactory in even other respects than the failure of "proof of knowledge." Even the location of the bettor was not established by convincing evidence. For example, Count 9 involves the Liston-Patterson fight. The witness Schuman originally denied that he bet on a heavy-weight championship fight in 1962. TR 206. Then, after examining his grand jury testimony, he testified that he did bet on this fight. TR 209. On cross-examination he was asked this question:

"Q. So, in other words, let me ask you this question again. On that fight, can you swear that you called Mr. Cohen from San Francisco, California?

A. No.

Q. Now, with respect to the—any times you talked to Mr. Cohen about—

A. May I amplify that last answer? I can't absolutely swear to it, no. To the best of my recollection, yes. But with a man's safety at stake and an absolute swearing, no."

Later he testified that he was 99% sure that the call was made from the San Francisco area. TR 275. He was never able to recall the amount of the bet (TR 276) or exactly where he was when he made the bet (TR

277) and he never informed Mr. Cohen from where he was talking. The testimony is replete with indications of the close social relationship between the parties going back over thirty years. The witness Schuman could not swear whether or not he was in Hillsborough or in San Francisco when any of the calls were made. He also indicated that he called the defendant Lesly Cohen while in Las Vegas. TR 263.

As will be pointed out later, Count 7 is such an indefinite charge that it is close to impossible to tell from the transcript whether the calls the Government had in mind in the count were supported by the evidence or not. The only thing that is clear is that on some occasions Mr. Schuman did call Mr. Cohen from the Bay Area. That on occasion he discussed bets and that on occasion he discussed politics, but he had no clear recollection as to any particular conversation.

In addition, the entire Schuman testimony indicates the classic case of friends betting with friends on major sporting events. This is not the kind of thing which Congress sought to prohibit as will be seen later. The statute was aimed at the suppression of organized gambling activities not social betting between friends. As Attorney General Kennedy stated in his report to the Committee on the Judiciary contained in the hearings before the Committee on the Judiciary on S. 1655, June 9, et seq. 1961. Program to curb organized crime and racketeering

“Second, the bill would in that regard help suppress *organized* gambling by prohibiting the use of wire communications for the transmission of

gambling information in interstate and foreign commerce. The word 'organized' is italicized because it should be clear that the Federal Government is not undertaking the almost impossible task of dealing with all the many forms of casual or social wagering which so often may be effected over communication facilities. It is not intended that the act should prevent a social wager between friends by telephone. This legislation can be a most effective weapon in dealing with one of the major factors of organized crime in this country without invading the privacy of the home or outraging the sensibilities of our people in matters of personal inclinations and morals."

What occurred with Mr. Schuman was not the transmission of wagering information or bets involving organized gambling, but simply the casual and social kind of wagering which takes place between social acquaintances.

In our opinion conviction should not rest on the testimony of a witness who cannot swear to an essential fact required to prove the Government's case. Quoting odds where a felony conviction is involved may be a stimulating game of chance from a gambling point of view, but a criminal prosecution resulting in a conviction is not a sporting event. A conviction based on a gambler's chance should not stand.



#### IV. THE COURT'S INSTRUCTION ON INTENT CONSTITUTED REVERSIBLE ERROR.

The Court's instruction on intent was as follows:

"Intent may be proved by circumstantial evidence. Indeed, it can rarely be established by any other means. While witnesses may see and hear and so be able to give direct evidence of what a defendant does or fails to do, of course there can be no eye witness account of a state of mind with which the acts were done or omitted. But what a defendant does or fails to do may indicate intent or lack of intent to commit the offense charged. *As a general rule, it is reasonable to infer that a person ordinarily intends all the natural and probable consequences of acts knowingly done or knowingly omitted. So unless the evidence in the case leads the jury to a different or contrary conclusion, the jury may draw the inference and find that the accused intended all the natural and probable consequences which one standing under like circumstances and possessing like knowledge should reasonably have expected to result from any act knowingly done or knowingly omitted by the accused.*"

This instruction was objected to on pages 48 and 49 of the Reporter's Transcript of October 5, 1965.

The crime of which appellant was convicted requires a specific intent, that is to say the defendant must knowingly intend to accept the transmission of wagering information or bets over an interstate telephone line. The evidence tended to show in the instant case that specific phone calls were, in fact, accepted by appellant from the Bay Area and that these tele-

phone calls had to do with bets and betting. Appellant, however, was an employee of a legal betting establishment in Las Vegas and probably could and did accept telephone calls transmitting the same kind of information from within the State of Nevada. This, of course, was standard business procedure and did not constitute any crime. The instruction given by the Court, however, would allow the jury to presume his guilty knowledge of the character of the call from the mere fact that the call was, in fact, placed and received by him. This Circuit has specifically disapproved this instruction in cases where a specific intent is involved. In *Bloch v. United States*, 9th Circuit, 221 F. 2d 786, the Court, in fact, held that the giving of such an instruction on the subject of intent was such basic error that, even in the absence of objection, it required reversal. The Court stated as follows:

“That is not a correct statement of law with regard to a criminal offense wherein specific intent is an essential element. *Morissette v. U.S.*, 342 U.S. 246, 273, 72 S.Ct. 240, 96 L.Ed. 288; *Wardlaw v. U.S.*, supra. As the Supreme Court said in the *Morissette* case, supra, 342 U.S. at page 275, 72 S.Ct. at page 256:

“ ‘We think presumptive intent has no place in this case. A conclusive presumption which testimony could not overthrow would effectively eliminate intent as an ingredient of the offense. A presumption which would permit but not require the jury to assume intent from an isolated fact would prejudge a conclusion which the jury should reach of its own volition. A presumption which would permit the jury to make



an assumption which all the evidence considered together does not logically establish would give to a proven fact an artificial and fictional effect. In either case, this presumption would conflict with the overriding presumption of innocence with which the law endows the accused and which extends to every element of the crime. Such incriminating presumptions are not to be improvised by the judiciary. Even congressional power to facilitate convictions by substituting presumptions for proof is not without limit.'

"The conclusion sought to be supplied by presumption in the *Morissette* case was one of intent to steal casings, based upon the mere fact the defendant took them. What was said in that case applies equally to the case at bar where under the above portion of the trial Court's charge the jury was told in effect that they could draw the conclusion that the appellant had intended to defeat or evade the payment of his tax from the mere fact that he filed an incorrect income tax return."

As in the *Morissette* and *Bloch* cases the giving of the instruction under attack *here* would allow a presumption of intent from facts which have no logical relationship sufficient to compel a presumption of guilty knowledge.

In a case of this character, where the act constituting the criminal offense is *mala prohibita* rather than *mala in se*, it would appear that this instruction requires reversal. *Mann v. United States*, 319 F.2d 404. See also *United States v. Palermo*, 295 F.2d 872; *Haner v. United States*, 315 F.2d 792; *Forester v. United States*, 9th Circuit, 237 F.2d 617.

**V. THE FAILURE OF THE COURT TO INSTRUCT ON  
"SOCIAL WAGERS" WAS ERROR.**

The defense submitted two instructions on the subject of social rather than business wagers. These instructions are as follows:

**"Instruction No. 11**

"The Government must show beyond a reasonable doubt that the defendant accepted the wagers or transmitted betting information charged in the indictment in connection with a business of accepting wagers. Personal bets with personal friends unconnected with the gambling business are not a violation of the statute charged in the indictment." TR 50

**"Instruction No. 17**

"Wagers on sports events or contests, to be taxable, must be placed with a person engaged in the business of accepting such wagers. The purpose of this requirement is to exclude from tax the purely 'social' or 'friendly' type of bet. A person is considered to be in the business of accepting wagers if he is engaged as a principal who, in accepting wagers, does so on his own account." TR 51

The failure of the Court to grant these instructions was excepted to on page 49 of the hearing of October 5, 1965.

Instruction 17 is a direct quote from the case of *United States v. Simon*, 241 F.2d 308 at 310, quoting Congress' report on the wagering tax law. Attorney General Kennedy in submitting Section 1084 to Congress indicated that Section 1084 contained a like requirement:

“The statute on interstate transmission of gambling information was designed to “help suppress *organized* gambling by prohibiting the use of wire communications for the transmission of gambling information in interstate and foreign commerce.

“ ‘The word “organized” is italicized because it would be clear that the Federal Government is not undertaking the almost impossible task of dealing with all the many forms of casual or social wagering which so often may be effected over communication facilities. It is not intended that the act should prevent a social wager between friends by telephone.’ ”

Throughout the legislative history it is clearly indicated that the statute excluded a social-type bet. There was evidence from which the jury could find the Schuman transactions were social in character. The lack of such an instruction was prejudicial to the defendant.

In the instant case Adolph Schuman and appellant were friends of thirty years standing. They met often in Las Vegas. TR 244 through 248. The entire transaction with Mr. Schuman is peculiar in that nowhere is it indicated that any money ever changed hands as a result of the bets made by him and Mr. Cohen. The bets were made on not the casual sporting event but on the important kind of super event on which social wagers are customarily made. It is submitted that this kind of wager is not the kind of activity contemplated by Congress as a violation of Section 1084 of Title 18.

**VI. THE COURT'S INSTRUCTIONS ON THE "BUSINESS OF WAGERING" WERE IMPROPER.**

The Court instructed the jury that the test of whether a person was in the business of wagering was as follows:

"The test of whether a person is in the business of accepting wagers is whether he is accepting money in a game of chance in which someone may win or lose, depending on the eventuality. In the event the government does not prove that the defendant here, either in his behalf *or the behalf of someone else*, accepted the risk of winning or losing the wager he is accused of accepting, you must find the defendant not guilty." (Emphasis added.)

This instruction was objected to on page 48 and the defense submitted Instructions No. 1, TR 52; No. 2, TR 52; No. 9, No. 11, TR 50; No. 12, TR 50; and No. 17, TR 51. All of the instructions submitted by the defense adopted the principle established by *United States v. Calamaro*, 354 U.S. 351; *United States v. Simon*, 241 F. 2d 308; and Internal Revenue Regulation Section 44.4401-2(b) that, in order for one to be in the business of accepting wagers or wagering, he must have a proprietary interest and must bear the risk of winning or losing.

Section 1084 of Title 18, the section appellant is charged with violating, requires that an individual be in the "business of wagering or betting" to be subject to its sanctions. Almost identical language is used in connection with the wagering tax statutes defining those persons who are liable for the tax. Section

4401(c) refers also to the "business of accepting wagers." A violation of the provisions of Section 4401 would subject an individual to prosecution under the felony sections of the Internal Revenue Code.

Section 4411 of the Internal Revenue Code provides for an occupational tax for one receiving wagers "on behalf" of a person liable for the tax, and a violation of its provisions would subject an individual to prosecution for a misdemeanor. It should be noted that the instruction which the Court gave incorporates the language of the occupational tax section of the Internal Revenue Code, that is to say the section which gives rise to a misdemeanor.

The Court refused to give the instructions submitted by the defense which incorporates the language of the regulation under the Internal Revenue Code which determines whether or not an individual accepting wagers would be liable for felony prosecution. The regulation reads as follows:

"(b) *In Business of accepting wagers.*

"A person is engaged in the business of accepting wagers if he makes it a practice to accept wagers with respect to which he assumes the risk of profit or loss depending upon the outcome of the event or the contest with respect to which the wager is accepted."

Under well settled principles of statutory interpretation it is presumed that Congress intends to regulate the same subject matter where different statutes are involved as an integrated whole. If the same or similar language is used in one act, it is pre-



sumed that the language should be interpreted similarly in another. It is our contention that Congress did intend to correlate the two acts, that is to say the 1951 Wagering Tax Act and the 1961 Communications Act having to do with wagering. Furthermore the legislative history shows it.

At the opening of the hearings before the United States Senate on Tuesday, October 22, 1961, before the Subcommittee on Investigations of the Committee on Government Operations, United States Senate, the Chairman, Senator John L. McClellan, stated "One important aspect in this situation is that the wagering stamp tax law has been a disappointment from the viewpoint both of collecting revenue and of getting rid of bookmakers." Mortimer M. Caplin, Commissioner of Internal Revenue, testified at length concerning the experience with the wagering tax law. He also indicated that the Internal Revenue Service did not desire the service involved "in what are essentially policing procedures distinct from revenue collections." Page 95 of hearings. The report of the Committee on Government Operations of the United States Senate, Report 1310, is replete with reference to the wagering tax law and the difficulties of enforcement thereunder.

The imposition of the same requirement in the 1961 Act as in the wagering tax law that to be criminal "the defendant must be in the business of wagering" to have committed an offense would imply an approval of the regulations which were promulgated under the wagering tax law. Regulation 44.4401-2(b) imposes a requirement which is both equitable and sensible with

respect to a crime which is a felony. It defines the business of wagering in terms of two factors: one, a practice of accepting wagers, and two, the assumption of the risk of profit or loss.

In the instant case, as the Government conceded at the time of trial, there is no evidence that Lesly Cohen assumed the risk of profit or loss and the isolated transactions over a period of two years did not indicate that Mr. Cohen was in the practice of accepting interstate wagering. In fact, just the contrary is shown. The only evidence here involved is that the defendant accepted an interstate wager from an old friend. The only inference which was presented to the jury is that Mr. Cohen acted as Mr. Schuman's agent in placing a legal bet in the State of Nevada. There is simply no evidence here from which the jury could conclude that Mr. Cohen had a proprietary interest in the bet as required by the Supreme Court in the *United States v. Calamaro*, 354 U.S. 351 and the regulation. See *United States v. Simon*, 241 F. 2d 308.

It should be noted that the *Calamaro* case is referred to in the legislative hearings although not by name. Since its reasoning was not specifically disapproved, this Court should adopt its reasoning with respect to the case at bar. The *Calamaro* case indicates that, in order to be in the business of wagering, a defendant must have a proprietary interest and must be betting on his own account. The only exception is the licensing requirement that those who accept bets "on behalf" of someone else must register, but this is specified by statute. 26 USC 4412.



The language of this statute was not in the act charged violated at bar. It would follow therefore that the basic test of being in the business of wagering should be followed by this Court. There is no evidence from which it can be concluded that this defendant accepted bets for his own account. Therefore, there is insufficient evidence to support the charge. In this connection it should be noted that the violation of the wagering-licensing requirements are misdemeanors, where violation of the wagering tax law constitutes a felony.

As has been indicated above, we believe that the legislative history of Section 1084 clearly indicates that Congress had in mind the wagering tax law of 1951 when it enacted the section. The test of being in the business of wagering given by the Court includes an individual who accepts a wager "on behalf of" someone else. This instruction actually incorporates Section 4412 of Title 26, United States Code, which requires a person accepting wagers "on behalf of another" to register and pay tax. The language used in Section 1084, however, does not include the language "on behalf of" but merely refers to a person in the business of wagering.

This language is for all practical purposes identical with the language of Section 4401 of Title 26, United States Code, and the regulations under that Section 44.4401-2(b) defines the business of wagering in the manner above referred to. Section 1084 is a felony. Section 4401 is a felony. It would appear logical that by not including the language "on behalf of" in Sec-

ion 1084 Congress intended the more stringent requirement for a felony conviction. The defense submitted Instructions 1, 2, 9, 12 and 17 all of which appear to us to be the correct statement of the test of being "in the business of wagering." What Congress prohibited was not the isolated transaction nor did it intend felony conviction for employees, otherwise Congress would have added the language contained in Section 4412, that is to say, the language on behalf of."

Since defining appellant's status was an essential element of the crime charged, we feel that the Court's instructions constituted reversible error and in addition as a matter of law the evidence was insufficient.

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#### **VII. THE COURT'S INSTRUCTION ON "IGNORANCE OF THE LAW" WAS IMPROPER.**

The Court instructed the jury as follows:

"It is not necessary for the prosecution to prove knowledge of the accused of the particular act or failure to act is in violation of law unless and until outweighed by evidence in the case. To the contrary, the presumption is that every person knows what the law forbids and what the law requires to be done."

This instruction was objected to at pages 48 and 49 of the Reporter's Transcript of October 5, 1965. The statute here involved was quite recently enacted by Congress at the time of the commission of the offense here involved. The business of gambling insofar as

appellant was concerned was a legal one and the crime of which he is accused is *mala prohibita* rather than *mala in se*. In the instant case, therefore, it would appear to be an essential ingredient of the Government's proof to show that the defendant acted with a bad purpose and with a conscious desire to break the law. What little evidence there was to show this knowledge was equivocal and need not have been believed by the jury. The defense, however, was precluded from arguing to the jury that the Government had failed in its burden of proof in this respect. We believe that giving this instruction in a case of this character constitutes an error. See *Edwards v. United States*, 321 F.2d 342. Affirmed on rehearing. In our opinion this Court should adopt the reasoning of the first *Edwards* opinion and hold that in these circumstances the Government is not entitled to a presumption that the defendant knew he was breaking the law but must, in fact, satisfy the jury by competent evidence that the defendant knew he was breaking the law.

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**VIII. THE COURT IMPROPERLY LIMITED CROSS-EXAMINATION OF THE WITNESS SCHUMAN.**

The conviction of appellant ultimately rested entirely on the testimony of the witness Adolph Schuman. In connection with his examination the witness Schuman was asked whether or not he asked for immunity from prosecution in return for testifying against appellant. The witness denied that he had asked or received immunity in any form. TR 272.

Exhibit 16 of the Government contained a report of an interview of the witness Schuman by Internal Revenue Agents. In this "report of interview" the Government reported Mr. Schuman, stating as follows:

"Both Mr. Schuman and his attorney assured me that given the proper immunity any information which they might have relating to our inquiry would be given completely and truthfully." TR 278.

The witness Schuman was crucial to the Government's case. His motive for falsification or exaggeration would have to the jury a definite effect in considering his vague and ambiguous testimony. The fact that he requested immunity from prosecution was a significant factor in judging his credibility. Since he had specifically denied under oath his own statements, the defense was improperly precluded from a thorough and complete cross examination of this witness. In the circumstances of the cases here where the jury sustained the allegations of the indictment only with respect to him, this limitation on cross examination would be reversible error.

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**THE COURT ERRED IN ADMITTING OVER OBJECTION THE SO-CALLED COMMON PLAN SCHEME AND DESIGN AS EVIDENCE.**

The Court allowed the introduction of evidence tending to show that the defendant had committed other offenses of a like character with the witnesses

Hochfield, Drossman and Stead in 1961. As the Court stated in *Kraft v. United States*, 238 Fed. 2d 794,

“Evidence of this character necessitates the trial of matter collateral to the main issue is exceedingly prejudiced, is subject to being misused, and should be received, if at all, in a plain case.”

See also

*Paris v. United States*, 260 Fed. 2d 529, 531.

This is the kind of evidence that the Government introduces at its peril. In no case did the Government prove any knowledge on the part of the defendant that the call was interstate in character. In each of the calls, in part at least, were innocent because of the closeness of the conversations to the passage of Section 1084 on September 13, 1961. No offense was proven and, therefore, under the ordinary rules, a new trial should have been granted on this ground. As the Court stated in *Mora v. United States*, 190 Fed. 2d 749,

“It is ordinarily reversible error for the trial court to admit evidence of an offense other than the one on trial.” See *Wiley v. United States*, 257 Fed. 2d 900.

The Court instructed the jury to disregard the testimony of the witness Stead. We, however, believe that the Court cannot unring the bell on this kind of evidence. Similar offense evidence is so prejudicial that, when the jury is allowed to hear it, no amount of cautionary instructions can cure the error. *Sang Joon Sur v. United States*, 9th Circuit 167 Fed. 2d 431, *Boyd v. United States*, 142 U.S. 450, 458. The



evidence was introduced to prove intent and to show absence of mistake or inadvertence. However, the evidence showed no more than the defendant received phone calls. Nothing was shown from which it could be determined that the defendant knew the calls were from out of state, except in the case of the witness Grossman where the conversations in that respect occurred before September 13, 1961, and indicate an innocent rather than a guilty intent.

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**THE CONVICTION ON COUNT 7 WAS IMPROPER SINCE THE COUNT IS DUPLICITOUS. ONE CHARGE CONNECTED THEREIN IS UNSUPPORTED BY THE EVIDENCE.**

The charge contained in Count 7 refers, according to the Bill of Particulars, to two bettors, one Raymond Syufy and the other Adolph Schuman. Syufy was unable to identify the defendant as the individual with whom he had telephone conversations. The evidence is insufficient, therefore, to prove a violation with respect to his testimony. However, there is no way in which the Appellate Court can determine whether the jury's conviction rested on the testimony of Syufy or whether it rested on the testimony of Adolph Schuman.

As we have previously indicated, we do not believe that the evidence was sufficient with respect to Mr. Schuman either since there was no evidence from which the jury could infer knowledge of Mr. Schuman's location at the time the call was made. However, assuming for the sake of argument that a conviction could rest on a jury finding with respect to

Schuman since the verdict was general, it is impossible to determine whether or not the conviction rested on the testimony to Syufy. As stated in *Bollenbach v. United States*, 326 U.S. 607,

“the decisions are plentiful that an Appellate Court cannot affirm a conviction erroneously secured on one theory on the speculation that conviction would have followed if the correct theory had been applied.”

If a conviction could have rested on either of two grounds, one valid and the other invalid, the Court cannot presume that the jury rested its finding on the valid ground. *Williams v. United States*, 317 U.S. 287; *Yates v. United States*, 354 U.S. 298; *Beck v. United States*, 9th Circuit, 298 F.2d 622; *Wilson v. United States*, 250 F.2d 312; *United States v. Palermo*, 299 F.2d 872. We should observe that we moved to dismiss this count on the grounds that the count was duplicious. The verdict in this case illustrates in a concrete way the danger which we previously pointed out to Judge Carter.

A motion was made to Judge Carter to dismiss the count of the indictment on the grounds that it was duplicitous. Duplicitous in indictment generally means the charge of two or more separate offenses in one count. *Travis v. United States*, 247 F.2d 130; *United States v. Lennon*, 246 F.2d 24. Here two separate telephone conversations are involved with two separate individuals. From two to seven different calls are probably involved, although the pleading and Bill of Particulars are both so vague as to make the exact



number of telephone calls impossible to determine. In our opinion, each telephone call would constitute a separate offense and the charging of a number in the same count makes that count duplicitous.

Ordinarily duplicity does not assume the importance that it does in the instant case. Here the danger of duplicity is clearly shown, since in the present case it is impossible to determine which witness the jury believed or to determine which offense, if any, on which they convicted the defendant. This count should, therefore, be dismissed by the Court.

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### CONCLUSION

The Attorney General's report submitting Section 1084 to the Congress indicates that Section 1084 was designed to inhibit organized gambling and organized crime. The evidence in this case establishes nothing of the kind, but only social wagering at isolated times with a friend of thirty years standing. In our opinion, in view of all the circumstances of the case, including the impropriety of the instructions and the denial of hearing on appellant's Motion to Suppress, the conviction should not be allowed to stand.

Dated, San Francisco, California,  
July 18, 1966.

JOHN V. LEWIS,  
RICHARD H. FOSTER,  
*Attorneys for Appellant.*



#### CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD H. FOSTER,  
*Attorney for Appellant.*



**In the United States Court of Appeals  
for the Ninth Circuit**

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**LESLEY COHEN, APPELLANT**

*v.*

**UNITED STATES OF AMERICA, APPELLEE**

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**On Appeal from the United States District Court  
for the Northern District of California**

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**BRIEF FOR APPELLEE**

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 20,807

**LESLY COHEN, APPELLANT**

*v.*

**UNITED STATES OF AMERICA, APPELLEE**

---

**On Appeal from the United States District Court  
for the Northern District of California**

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**BRIEF FOR APPELLEE**

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**JURISDICTION**

Jurisdiction is invoked by appellants under the provisions of Section 1291 and 1294(1) of Title 28, United States Code. Jurisdiction was invoked by the Government in the District Court, Northern District of California, under the provisions of Section 1084 (a), Title 18, United States Code.

**STATEMENT OF THE CASE**

Inasmuch as appellant's statement of the case is not complete, an amplification and extension of the factual background is provided.

Appellant was indicted on December 11, 1963, in a nine-count indictment charging violations of Section 1084(a), Title 18, United States Code. (R. 2-6).<sup>\*</sup> Counts one, two, three, four, five, six, eight and nine alleged that the appellant, being engaged in the business of betting and wagering, utilized interstate telephone communication facilities between the Northern District of California, and the District of Nevada to transmit wagers on certain sporting events. Count seven of the indictment alleged that the appellant, while engaged in the business of betting and wagering, utilized interstate telephone communication facilities between the previously mentioned districts for the transmission of wagering information, such information being communicated for the purpose of assisting in the placement of a wager.

On January 23, 1964, appellant made a motion to suppress evidence which he alleged was obtained in violation of constitutional rights. (R. 11-13). The motion papers contained unsubstantiated charges that the Government tampered with appellant's mail and intercepted his telephone conversations. The only support for the motion is comprised in affidavit filed on January 29, 1965, by appellant's counsel. (R. 57-58). This affidavit asserts that on April 22, 1963, a letter was mailed to the appellant by appellant's counsel, and then speculates that, "this letter presumedly was intercepted by agents of the Internal Revenue Service in connection with the investigation of this defend-

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<sup>\*</sup> References are to the Transcript of Record (R.), and to the record of trial (Tr.).



ant." The affidavit also refers to the interview of unidentified Government witnesses by appellant's counsel and then infers that, "the content of . . . questions (addressed to such witnesses by Internal Revenue Service agents) was such that in order to ask the questions, . . . agents must have been familiar with the content of correspondence and with the content of the telephone conversations to which the questions referred." With these vague and indefinite conclusions of fact counsel for appellant in effect stated that he was told what others said they were asked, but does not even state what he was told they were asked. Not a single question or answer is mentioned in the affidavit.

In a Memorandum Opinion and Order filed April 21, 1965, United States District Court Judge George B. Harris denied appellant's motion without permitting oral testimony in support of the motion. (R. 59-63). Judge Harris' opinion noted that the vague assertions in the affidavit executed by appellant's counsel, were patently insufficient to create an issue in view of the categorical denials supplied in affidavit form by the Office of the United States Attorney (R. 28-30); and United States Post Office employees responsible for handling appellant's mail. (R. 51-56). The opinion also noted that the motion represented, "generalizations and blanket charges," that it was, "insufficient on its face," and that mail watches similar to the one employed by the Government in this case have been approved by well considered case authorities.

On October 5, 1965, the jury returned a verdict of guilty on Counts Seven and Nine of the indictment,\* and on November 30, 1965, the Trial Court denied a motion for a new trial and judgment of acquittal.

As noted, Count Seven relates to the transmission of wagering information as distinct from the transmission of wagers. The count refers to information transmitted during the football season of 1962, from Las Vegas, Nevada to San Francisco, California, "for the purpose of assisting in the placement of a wager on a football game in which the San Francisco Forty-Niners participated . . ." (R. 5). Count Nine relates specifically to the transmission of a wager, on or about September 15, 1962, from Las Vegas, Nevada to San Francisco, California, on a prize fight in which fighters Sonny Liston and Floyd Patterson participated. (R. 6).

Appellant contended prior to trial that Count Seven was duplicitous by reason of facts set forth in a Bill of Particulars filed by the Government on February 7, 1964. (R. 31-32); and an Amended and Corrected Bill of Particulars filed on February 27, 1964. (R. 34-35). With respect to these counts appellants Motion for a Bill of Particulars requested, "the name of the individual or individuals who allegedly wagered on the sporting events mentioned in each count. . . ." (R. 9). In direct response to this specific request the Government apprised the appellant through the medium of the Amended and Cor-

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\* Counts Two, Three, Four, and Six were dismissed at the close of the Government's case on motion of the Government.

rected Bill of Particulars that the witnesses Adolph P. Schuman and Raymond Syufy would testify concerning the charges contained in Count Seven. The duplicity contention was raised because the testimony of two witnesses related to the offense charged in Count Seven. The motion was denied in a Memorandum opinion filed on May 8, 1964. (R. 37).

### STATEMENT OF FACTS

During the course of the Government's presentation ten witnesses were called to testify. The testimony of one of these witnesses, Henry Wayne Stead, was stricken at the close of the Government's case with an instruction to the jury to disregard his testimony. (Tr. 511B). It is clear from the trial transcript that testimony elicited from the nine remaining witnesses was more than sufficient to establish the elements of proof required by the terms of Section 1084(a), Title 18, United States Code.

At the outset it should be noted that a portion of this proof established clearly that the appellant conducted a sports betting operation at the Saratoga Sports Book, a betting establishment located in Las Vegas, Nevada and licensed to conduct wagering activity in that city. (Tr. 163). The existence of the mentioned gambling establishment and the appellant's close connection with it is not controverted.\*

The following is a summary of significant testimony:

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\* Appellant's Opening Brief, p. 3.

**(a) Testimony of Adolph P. Schuman**

The witness Adolph P. Schuman provided a substantial portion of the testimony relating to Count Seven and Nine. His testimony was also pertinent with respect to the general element of proof that the appellant was a person, "engaged in the business of betting or wagering" as that phrase is utilized in Section 1084(a).

This witness testified that he made several bets on professional football games during the fall of 1962 with the appellant. (Tr. 95: 17-25). In testimony just prior to that cited, this witness stated that when betting with the appellant he received information from him which enabled him to decide how he would bet. In this regard the witness stated, "I would hardly make a bet before I found out what the price was." (Tr. 194: 17-4 n.p.\*). He testified that he was particularly interested in the San Francisco Forty-Niners during the 1962 football season, and that not less than two telephone bets on the Forty-Niners were made by him with the appellant during the course of telephone calls to the appellant in Las Vegas from the San Francisco area. (Tr. 273: 19-14 n.p.). He then testified that prior to making bets on the Forty-Niners with the appellant he asked for and received information concerning the odds relating to the games. (Tr. 274: 15-21). During the course of cross-examination on this point the witness testified that he received odds on the 1962 Forty-Niner football games from the appellant over the course of

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\* Next page of transcript.

the entire football season. (Tr. 258: 25-2 n.p.). In addition to the bets made on the Forty-Niners from the San Francisco area, this witness also testified that he placed some bets on the Forty-Niners when he was in Las Vegas. (Tr. 277: 9-11). His testimony presents no ambiguity with respect to the fact that he made telephone bets on the Forty-Niners from the San Francisco area. It is noted that with respect to the latter point the witness Schuman stated that only one of the 1962 Forty-Niner bets was placed in Las Vegas, and that other betting on this team was carried on over the telephone from the San Francisco area. (Tr. 196: 7-17).

The witness testified positively that all of the bets which he made during the fall of 1962 were made with the appellant, and that these bets came to a total of six or seven. (Tr. 198: 25-7 n.p.). Of this total about five were placed over the telephone from the San Francisco area. (Tr. 199: 8-13).

With respect to Count Nine, the witness Schuman testified that he bet on the Patterson-Liston fight in 1962, and that the bet was placed over the telephone from San Francisco to the appellant who was in Las Vegas. He also recalled that he was in the City of San Francisco at the time of the fight and that he saw the fight on television at the Golden Gate Theater in San Francisco. (Tr. 209: 7-6 n.p.). When asked on redirect examination whether he made the bet from Hillsborough, California, as distinguished from San Francisco, California, the witness replied that his recollection was that it was made with the



appellant from the area or vicinity of San Francisco. (Tr. 274: 22-4 n.p.; Tr. 276: 15-5 n.p.).

With respect to other specific betting activity with the appellant the witness Schuman testified that he made a series of bets on World Series baseball games in 1962. (Tr. 192: 1-14; Tr. 194: 10-13; Tr. 194: 17-4 n.p.). He also testified concerning other telephone bets on professional football placed with the appellant (Tr. 196: 18-7 n.p.; Tr. 198: 12-16); and other bets on prize fights. (Tr. 199: 14-16; Tr. 200: 4-17; Tr. 201: 11-14; Tr. 201: 20-7 n.p.).

With regard to the telephone procedure used, the witness testified that when calling from his office telephone in San Francisco, he would request his telephone operator to reach the appellant specifically, and that his operator would place the call to Las Vegas for him. (Tr. 203: 10-12; Tr. 203: 19-5 n.p.; Tr. 205: 1-9). This witness also testified that when he phoned the appellant from his home he would dial long distance to Las Vegas and ask for the appellant specifically and that he did not dial direct. (Tr. 205: 10-17).

The witness stated that bets were settled personally with the appellant at the end of the season in Las Vegas. (Tr. 275: 15-18; Tr. 275: 23-3 n.p.). However, the witness testified that there was no actual settlement in 1962. Their pattern of betting that year resulted in each breaking even. (Tr. 251: 11-7 n.p.).

On cross-examination the witness testified that in 1962 he may possibly have placed calls to the appellant for betting purposes from Los Angeles or New

York. However, he noted that he was definitely sure that some of the wagering calls to the appellant were made to him from the San Francisco area or the Northern District of California. (Tr. 256: 11-4 n.p.; Tr. 257: 8-12).

**(b) Testimony of Raymond Syufy**

The testimony of Raymond Syufy, like that of the witness Schuman, was extremely persuasive in connection with Count Seven. It was also meaningful in regard to proof that appellant was engaged in the business of betting and wagering.

From the betting practice employed by this witness, the jury could logically have inferred the witness would not have bet with the appellant without first receiving odds or wagering information from the appellant. (Tr. 328: 19-12 n.p.). With respect to the 1962 football season, the witness recalled betting on the East-West game held at Kezar Stadium in the San Francisco area. He recalled phoning the bet to "the Las Vegas number" (Saratoga), from the San Francisco area, and then going out to see the game. (Tr. 333: 24-18 n.p.). Of particular significance with respect to Count Seven is the fact that he also recalls making a bet on a San Francisco Forty-Niner football game in a similar fashion then going out to see the game. (Tr. 335: 24-9 n.p.; Tr. 336: 24-7 n.p.).

This witness was particularly recalcitrant and hostile. However, upon examination of his testimony it is apparent that he produced important details of evidence which tended to establish the guilt of the appel-



lant. Syufy testified that he knew the appellant as an individual connected with the Saratoga Sports Book in Las Vegas and also that the appellant was the only person that he knew at the Saratoga by name. (Tr. 330: 21-11 n.p.). This testimony to the effect that the appellant was the only person that the witness Syufy knew at the Saratoga Sports Book by name becomes extremely material in light of other testimony from him to the effect that the appellant was the only person he settled with in connection with his betting with the Saratoga Sports Book.

With respect to the settlement of his wagers, Syufy testified that he had a discussion with the appellant early in 1962 and that as a result of this conversation he arranged to settle gambling debts when he (Syufy) was in Las Vegas. The witness also stated in this regard that neither he nor the appellant were concerned about receipt of money owed to each other. (Tr. 365: 6-15; Tr. 366: 8-16; Tr. 367: 4-5 n.p.). He characterized his account with him as a "running tab." (Tr. 346: 6-10).

The witness Syufy specifically recalled two settlements made in 1962 relative to the betting arrangement described. (Tr. 314: 9-17). He testified that on the last occasion he left money for the appellant "at the cashier's cage" of the Riviera Hotel in Las Vegas. (Tr. 316: 1-10; Tr. 317: 10-23; Tr. 359: 2-16). This settlement included bets made from San Francisco to Las Vegas as well as others. The settlement was described as occurring in the latter part of 1962. (Tr. 357: 13-20 n.p.).

The witness also testified concerning a 1962 settlement which took place in the "Saratoga Sports Club." He identified the appellant in the courtroom as being the specific individual he settled with on that occasion. (Tr. 315: 8-25; Tr. 360: 10-8 n.p.). This settlement also included interstate bets as well as those made in Las Vegas. (Tr. 361: 9-11). After further questioning he stated that on this occasion the money may have been given to one of the appellant's assistants (Tr. 364: 3-9); and that the settlement related to a "running tab" covering a period of eight or ten months of wagering in 1962. (Tr. 364: 10-17).

Syufy indicated that he usually bet on weekends during the football season and that he bet on both college and professional games as well as some baseball games. (Tr. 348: 2-19). He stated that in 1962 and 1963 he placed calls to the Saratoga in Las Vegas from San Francisco (Tr. 311: 13-4 n.p.; Tr. 309: 15-19; Tr. 331: 18-4 n.p.); that he identified himself by saying, "This is Ray," (Tr. 310: 12-14), and that during the course of the conversation he placed bets. He recalled the conversations were unusual in that they lasted only two or three seconds. (Tr. 323: 7-13). In this regard he testified that, "... the conversation was not a lengthy conversation but a very short two or three second conversation where you made your wager and the party hung up immediately." (Tr. 323: 24-4 n.p.).

With respect to other betting activity, the witness testified that in the fall of 1962 he made several bets on baseball games. (Tr. 326: 10-22; Tr. 327: 21-24). With respect to these baseball wagers he testi-

fied that he would call Las Vegas, identify himself, ask for the odds, that he would receive an answer and then place his bet. (Tr. 328: 19-12 n.p.). He testified that his usual bets on these games amounted to two or three hundred dollars. (Tr. 329: 16-17).

Still another pattern of betting activity between this witness and the appellant occurred in the spring of 1963 at a time when the witness was in New York. The record reflects that he phoned the Saratoga to bet on a prize fight, and that he lost the bet and that the loss was later part of a settlement previously referred to. (Tr. 341: 6-23; Tr. 342: 17-25; Tr. 343: 19-17 n.p.; Tr. 345: 9-17; Tr. 379: 1-19).

(c) **Testimony of James Lane, Credit Manager and Office Manager, Lilli Ann Corporation, San Francisco; Jerry Hathaway, Commercial Engineer, Central Telephone Company, Las Vegas; James Moriarty, Special Agent, Pacific Telephone Company, San Francisco; and Raymond A. Langlois, Federal Bureau of Investigation.**

In connection with the testimony of the witness Schuman, James Lane was called by the Government to identify and testify concerning records obtained from Schuman's place of business, the Lilli Ann Corporation, San Francisco. Government Exhibits (20) and (21) reflect that certain Las Vegas telephone numbers were used by the Lilli Ann telephone operator when phoning the appellant at the request of the witness Schuman. (Tr. 230-232; 240). Lane also identified Lilli Ann Corporation records reflecting charges for a pattern of calls made to the pay telephone in the Saratoga in Las Vegas during the fall of 1962. (Government Exhibits (17), (18), and (19); Tr. 222-223; 228-230).

Government Exhibits (2), (3) and (4), introduced through the witness Jerry Hathaway, established the existence of appellant's residential telephone service in Las Vegas, and the telephone numbers assigned to the Saratoga Sports Book in Las Vegas. (Tr. 39-41).

Through the witness Langlois the Government introduced Government Exhibit (25), which indicated an extensive pattern of calls from a San Francisco phone used by the witness Syufy to call the Saratoga Sports Book. (Tr. 403-407).

#### (d) Testimony of Nathaniel Albert

The testimony of Nathaniel Albert is particularly significant when considered in connection with that of the witness Syufy. Albert stated that he worked for the Saratoga for about an eight year period ending about September 1963. (Tr. 161: 17-21). Albert testified that the appellant operated sports betting at the Saratoga (Tr. 163: 14-16); that the appellant accepted and paid bets there (Tr. 164: 8-10); and that the appellant "handled the entire (sports) department." (Tr. 164: 16-18). He recalled that for a period the appellant may have had one assistant identified as an individual named Gross, and that he had no assistant prior to the employment of Gross as far as Albert could recall. (Tr. 164: 19-6 n.p.).

These facts indicate appellant's close connection with sports betting at the Saratoga. They explain and corroborate the relationship Lesly Cohen maintained with Raymond Syufy, Adolph Schuman, and other bettors. Moreover, the nature of the operation, when considered in the light of the testimony of

Albert and better witnesses indicates that the appellant alone transacted sports wagering business with such witnesses.

**(e) Testimony of Soll C. Drossman and Frank Hochfeld**

The testimony of the witnesses Drossman and Hochfeld, together with other testimony outlined clearly established that the appellant was engaged in an extensive illegal interstate wagering business. These witnesses were also very persuasive on the issue of appellant's criminal intent in dealing with bettors outside the State of Nevada. Thus, this testimony reflects his state of mind of the appellant in dealings with Adolph P. Schuman and Raymond Syufy.

Frank Hochfeld clearly established a pattern of betting on sporting events late in 1961 and early 1962. This testimony was strongly corroborated by the introduction of cashier's checks in settlement of his wagering activity (Government Exhibits (5), (6), (7), and (8); Tr. 303: 24-2). The testimony of this witness is also significant because he proved conclusively that the appellant was well aware of the Federal gambling statutes in 1961. In this regard the witness clearly stated that in 1961 the appellant advised him (Hochfeld) not to phone bets because it was unlawful for the appellant to accept them. (Tr. 296: 14-22; Tr. 297: 1-18; Tr. 298: 13-23; Tr. 300: 5-6, 18-22; Tr. 302: 21-13 n.p.; Tr. 304: 3-9). Though the appellant elected to inform the witness Hochfeld of the criminality involved in his activities, the record reflects that he chose not to discontinue his



subsequent relationship with Adolph P. Schuman, and that he did not inquire concerning Schuman's location. (Tr. 276: 4-10). He apparently chose to continue his subsequent illegal relationship with the witness Raymond Syufy also as the record indicates that Syufy was never questioned concerning his location. (Tr. 364: 19-22).

The Hochfeld testimony reflects a significant portion of the basis for the jury's conclusion that the appellant acted with a consciousness of guilt in his subsequent interstate wagering transactions with Adolph P. Schuman and Raymond Syufy.

The testimony of Soll C. Drossman indicated a clear pattern of interstate betting between the appellant in Las Vegas, and the witness Drossman in Tucson, Arizona. Drossman testified that during Labor Day weekend of 1961 he had a conversation with the appellant (Tr. 11: 10-12; Tr. 19: 13-16), and that it took place in the Saratoga Sports Book (Tr. 20: 1-16). Drossman testified that he asked for and received permission from the appellant to phone him from Tucson to place bets. He also stated that the appellant gave him a card with a number which he should use when calling him in Las Vegas. (Tr. 20: 20-6 n.p.; Tr. 90: 7-18). He testified that he thereafter called the number after returning to Tucson and asked for the appellant (Tr. 21: 7-9, 16-24; Tr. 22: 20-22); and that he called this number given to him by the appellant on more than one occasion. (Tr. 22: 23-25). He testified that he also phoned the number to place bets during the summer of 1962 while in Las Vegas. (Tr. 23: 8-16; Tr. 24: 1-11).

All settlements were thereafter made with the appellant personally either in cash on a weekly basis (Tr. 27: 17-22), or by mailing cashier's checks or registered mail to the appellant specifically. (Tr. 27: 11-16; Tr. 30: 5-7; Tr. 33: 9-14; Tr. 34: 9-13).

The witness' practice with respect to football bets was to receive the line from the appellant over the telephone before placing bets with the appellant. (Tr. 31: 15-24). When calling he would say, "Les, this is Soll from Tucson," and then would place his bet. (Tr. 32: 17-24). The record shows that appellant never inquired concerning Drossman's location, (Tr. 80: 20-25), or that he took steps to terminate his relationship with Drossman.

#### STATUTE INVOLVED

Title 18, United States Code:

Section 1084 (a)—"Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined not more than \$10,000 or imprisoned not more than two years, or both."



**QUESTIONS PRESENTED**

1. Whether the affidavit filed by appellant's counsel on January 29, 1965, as a basis for a hearing on a motion to suppress was legally sufficient to warrant a hearing?

2. Was the evidence sufficient to show a knowing or intentional use of interstate wire communication facilities?

3. Did the Court err in its instruction to the jury on the issue of criminal intent?

4. Whether the phrase "engaged in the business of betting or wagering," in Section 1084(a), Title 18, United States Code, may be equated with the phrase, "engaged in the business of accepting wagers," in Section 4401(c), Title 26, United States Code.

5. Did the Court err in its instruction to the jury that every person is presumed to know what the law forbids and what the law requires to be done?

6. Whether the Court improperly limited the cross-examination of the witness Adolph P. Schuman?

7. Whether Count Seven of the indictment was made duplicitous by reason of information contained in the Amended and Corrected Bill of Particulars?

8. Did the Court err in the admission of testimony supplied by the witnesses Soll C. Drossman, Frank Hochfeld and Henry Wayne Stead?

## ARGUMENT

- I. The Affidavit Filed by Appellant's Counsel as a Basis for a Hearing on Appellant's Motion to Suppress was Legally Insufficient
  - A. *Appellant offered no prima facie showing that a mail watch utilized by the Government went beyond merely observing what was visible on the outside of mail addressed to the appellant.*

Mail covers or mail watches have proven to be an invaluable aid in the detection of crime over the years. In practice a postal employee merely observes the exterior of mail for the purpose of recording the name and address of the sender, the place and date of the postmark, and the class of mail. Mail is neither delayed nor opened and the content of the mail matter is not observed. The record discloses that only a mail watch of the type described was employed during the course of investigating appellant's interstate wagering activities. (R. 51-56).

The practice of conducting mail covers has received judicial approval in the case of *United States v. Costello*, 255 F. 2d 876, 881-882 (2nd Cir. 1958), *cert. denied* 357 U. S. 937, *reh. denied* 358 U. S. 858. In that case the question of the applicability of Sections 1701, 1702, and 1703 of Title 18, was raised in connection with the denial of a motion for a new trial on the ground of newly discovered evidence relating to an alleged illegal mail watch. After noting that the delay in delivering Costello's mail never amounted to more than one delivery, the Court stated:

We do not think this comes within the proscription of Section 1701 which declares that

anyone who “knowingly and willfully obstructs or retards the passage of the mail” shall be guilty of a crime.

Nor do we think there has been any violation of Section 1702 which in pertinent part, declared it to be a crime for anyone to take any letter “. . . out of any post office . . . or which has been in any post office . . . before it has been delivered to the person to whom it was directed, with design to obstruct the correspondence, or to pry into the business or secrets of another . . . .” It is undisputed that the mail here in question was never taken “out of any post office” prior to delivery, or that it was ever opened as above stated. . . . We think this does not come within the prohibition against “taking” a letter or prying into another’s secrets or business as used in the statute.

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Section 1703(a) penalizes any “Postal Service employee” who “unlawfully detains, delays, or opens any letter . . . which shall come into his possession . . . .” However, as we have held in interpreting that section, detention alone without proof that it was for an unlawful purpose does not constitute a violation of this section. (Citing authority).

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We conclude that the mail watch was not illegal.

Subsequently, in *United States v. Schwartz*, 283 F. 2d 107, (3rd Cir. 1960), cert. denied 364 U.S. 942, the mail watch procedure provided by postal regulations was again fully explored and it was specifically held

that such a procedure was not illegal and that it was not violative of any constitutional rights of the addressee. In the *Schwartz* case a mail fraud conviction was based solely upon evidence obtained through a mail watch.

On March 5, 1964, in the trial of Roy M. Cohn in the Southern District of New York, United States District Judge Archie O. Dawson ruled in an unreported decision that mail watches used during investigation were not a violation of the defendant's constitutional rights. *United States v. Roy M. Cohn*, Docket No. 63 Cr. 748, (S. D. N. Y., March 4, 1964).

While the Supreme Court has never passed directly on the question the Court strongly indicated in *Ex parte Jackson*, 96 U. S. 727, 733 (1877) that while sealed letters were protected by the Fourth Amendment, it would nevertheless be proper to examine the outside of such letters and to take cognizance of what appears thereon. The following language from the opinion is pertinent:

[A] distinction is made between different kinds of mail matter—between what is intended to be kept free from inspection, such as letters, and sealed packages subject to letter postage; and what is open to inspection, such as newspapers, magazines, pamphlets, and other printed matter, purposely left in a condition to be examined. Letters and sealed packages of this kind in the mail are as fully guarded from examination and inspection, *except as to their outward form and weight*, as if they were retained by the parties forwarding them in their own domiciles. (Emphasis Supplied.)

In this case the mail watch employed by the Post Office Department was described in a detailed manner in three affidavits supplied by the Government with a Supplemental Memorandum filed in opposition to appellant's motion to suppress. (R. 49). These affidavits executed by Robert Lias, United States Postmaster, Las Vegas, Nevada, and mail carriers Harry White, and Richard Logan, Las Vegas, indicate clearly that normal Post Office procedures were followed in connection with the mail watch. (R. 51, 53, 55). The affidavits of Logan and White reflect that they individually were responsible for effecting the mail watch, and that in so doing, mail was not opened, nor was any attempt made to ascertain the contents of such mail. At no time did the mail watch result in their departing from the Post Office with mail after the time scheduled for such departure. The three affidavits indicate that the appellant never complained or commented to the three affiants concerning the delivery of appellant's mail.

Appellant's original motion to suppress filed on January 23, 1964, contained no affidavit in support of allegations relative to illegality in the conduct of the mail watch. (R. 11). More than a year later on January 29, 1965, counsel for appellant filed the affidavit upon which he now relies as a basis for allegations relating to alleged tampering with the mail. However, this affidavit alleges no evidentiary facts to indicate observation of the contents of appellant's mail.

Though appellant alleged no facts to warrant the calling of witnesses for a hearing on his motion to



suppress, the trial record clearly reflects that he was given wide latitude with respect to cross-examining Government witnesses concerning their mailings to the appellant. In this regard counsel for appellant cross-examined the witness Soll C. Drossman in an unsuccessful effort to establish that registered letters sent to the appellant by Drossman were opened by Government agents. The testimony of Drossman is devoid of any indication of irregularity. (Tr. 95: 1 to 97: 8).

Further unsuccessful efforts along the same line were made with the second Government witness, Henry Wayne Stead. (Tr. 120: 8-12; 149: 9-15). On redirect examination it was conclusively brought out that Government agents in no way indicated to Stead that they were aware of the contents of registered letters sent by the witness Stead to the appellant. (Tr. 138: 20 to 139: 21; Tr. 149: 19-22).

Apparently counsel for appellant realized that further interrogation would only have the effect of completely negating his unsupported allegations relating to tampering with the mails as the record discloses that the witnesses, Adolph P. Schuman, Frank Hochfeld and Raymond Syufy, were not cross-examined on the subject.

Appellant's brief alludes to the mail watch employed in this case as posing an interference to appellant's right to counsel under the Sixth Amendment of the United States Constitution. In this regard he cites the previously mentioned unreported opinion in the Roy M. Cohn prosecution in the Southern Dis-

trict of New York \* and *Massiah v. United States*, 377 U. S. 201 (1964).

The record is devoid of any indication of interference with appellant's relationship with counsel. In the absence of a showing that appellant's rights were infringed there can be no basis for the application of such authority. Moreover, the inapplicability of *Massiah v. United States* is apparent. There the facts indicated the use of an electronic eavesdropping technique on an indicted defendant who had retained an attorney and pleaded not guilty. Incriminating statements made by the defendant in *Massiah* were overheard by authorities and used against him during trial. The Court held that Sixth Amendment guarantees were denied him because incriminating statements had been elicited from him in the absence of counsel.

*United States v. Roy M. Cohn* involved mail watches ordered by prosecuting attorneys after indictment of the defendant. In that case watches were instituted on mail of the defendant and his attorney. Though the Court questioned the use of such a technique on a known defense counsel after indictment, it was specifically held that no constitutional rights of the defendant were infringed.

Other authorities cited in appellant's brief do not relate to mail watches and are clearly not in point. *Hoover v. McChesney*, 81 Fed. 472 (Cir. Ct. D. Ky. 1897) related to a refusal to deliver mail to the plaintiff by reason of a statute giving the Postmaster Gen-

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\* Docket No. 63 Cr. 748, (S. D. N. Y., March 4, 1964).



eral administrative authority to withhold mail from individuals or companies conducting lotteries. In *McChesney* there was an actual detention and illegal seizure of the mail. Similarly *American School of Magnetic Healing v. McAnnulty*, 187 U. S. 94 (1902) related to a complete withholding of mail under administrative authority conferred by an act of Congress. The facts in *Pike v. Walker*, 121 F. 2d 37, (D. C. Cir. 1940), *cert. denied* 314 U. S. 625, related to the transmission of matter declared to be non-mailable by reason of being violative of federal mail fraud statutes. *Walker v. Popenoe*, 149 F. 2d 511 (D. C. Cir. 1945), related to the barring of obscene matter from the mails and the procedural steps which must precede such action, and *United States v. Halseth*, 342 U. S. 277, (1952), involved the construction of a criminal statute forbidding the mailing of letters, packages and postal cards "concerning any lottery" or similar scheme.

*Fixa, Postmaster, San Francisco, et al. v. Heilberg*, 381 U. S. 301 (1965),\* cited in appellant's brief involved the construction of Section 305(a) of the Postal Service and Federal Employees Salary Act of 1962, which requires the Postmaster General to detain and deliver only upon the addressee's request, unsealed foreign mailings of "communist political propaganda." The Act as construed and applied was held to be unconstitutional since it imposed on the addressee an affirmative obligation amounting to an unconstitu-

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\* Decided with *Lamont, dba Basic Pamphlets v. Postmaster General*, 381 U.S. 301 (1965).

tional limitation of the freedom of speech under the First Amendment. The decision in that case noted that the opinion rested "on the narrow ground that the addressee in order to receive his mail (had to) request in writing that it be delivered." Needless to say, such a procedure was not employed in this case.

In addition to the use of mail covers by the Postal Inspection Service in connection with mail fraud, and obscenity investigations, the Post Office utilizes the technique at the request of other Federal investigative agencies for the purpose of uncovering other forms of crime. The types of investigations wherein it has been helpful include espionage and sabotage cases, gambling, narcotics and smuggling, as well as others.

In summary the mail cover technique is a valuable investigative aid used in the detection of serious Federal crimes, and has been explicitly held not to be violative of any Federal statute or Constitutional right.

***B. Appellant offered no prima facie showing which would warrant a hearing into allegations of wiretapping.***

In order to secure a hearing on the admissibility of suspected evidence, it is incumbent upon the defendant, at the earliest possible time, to prove to the trial court's satisfaction that such evidence was illegally obtained. *Nardone v. United States*, 308 U. S. 338, 341-342, (1939). In referring to this defense requirement the following language was used by the Court in *Nardone*:

To interrupt the course of the trial for such auxiliary inquiries impedes the momentum of the main proceeding and breaks the continuity of the jury's attention. Like mischief would result were tenuous claims sufficient to justify the trial courts indulgence of inquiry into the legitimacy of evidence in the Government's possession . . . therefore claims that taint attaches to any portion of The Government's case must satisfy the trial court with their solidity and not be merely a means of eliciting what is in the Government's possession before its submission to the jury.

The accused has the burden of first proving that the prosecution has employed wiretapping before a hearing is warranted. *United States v. Coplon*, 185 F. 2d 629, 636 (2nd Cir. 1950), *cert. denied* 342 U. S. 920; *United States v. Goldstein*, 120 F. 2d 485 (2nd Cir. 1941), *aff'd*, 316 U. S. 114 (1942). Affidavits offered in support of such a motion must contain more than "sheer guess work." *United States v. Flynn*, 103 F. Supp. 925, 930 (S. D. N. Y. 1951), *aff'd*, 216 F. 2d 354 (2nd Cir. 1954), *cert. denied*, 348 U. S. 909, *petition for reh. denied* 348 U. S. 956. In *United States v. Weinberg*, 108 F. Supp. 567, 569 (D. D. C. 1952), it was held that, "mere conjecture," was not sufficient. The following language was used in the *Weinberg* case:

The defendant's affidavits do not allege that there is, in fact, any evidence whatever that will be offered by the Government based on intercepted telephone messages. *There is an entire lack of definitiveness as to any particular interception . . . The defendant's conclusions have mere*

*suspicious and innuendos as their premises.* This is not the "solidity" and affirmative proof necessary and therefore does not merit a hearing under the Nardone Rule. Courts need a reasonable assurance that the evidence challenged is tainted or is "a fruit of the poisonous tree"; mere conjecture will not suffice. (Emphasis added.)

In *United States v. Pardo-Bolland*, 229 F. Supp. 473, 475 (S. D. N. Y.), aff'd 348 F. 2d 316 (2nd Cir. 1964), cert. denied 382 U.S. 944 the District Court stated:

The moving affidavit by defendant is so lacking in specific statements of evidentiary facts that it fails to raise an issue . . . The charges are so manifestly devoid of evidential support that they require neither an answer nor a hearing. The burden is upon the defendant to establish that his wires have been tapped. (Citing authority.) That burden requires allegations of evidentiary facts upon personal knowledge, or at least disclosure of the sources of the deponent's information and the ground for his belief to support a demand for a hearing.

Appellant appears to imply that he is entitled to a hearing by making more general assertions in affidavit form. It has been held that evidence in support of such a motion must be "shown with sufficient clarity or definitiveness to warrant the holding of a pre-trial hearing. . . ." *United States v. Frankfeld*, 100 F. Supp. 934, 939 (D. Md. 1951), aff'd, 198 F. 2d 679 (4th Cir. 1952); *United States v. Fujimoto*, 102 F. Supp. 890 (D. C. D. Hawaii 1952).

In *United States v. Casanova*, 213 F. Supp. 654, 656 (S. D. N. Y. 1963) the Court in commenting on the complete absence of any evidential material in support of a motion to suppress stated:

If one were compelled (to have a hearing) under the circumstances here presented, then every defendant in a criminal case could make similar unsupported charges and with equal justification demand a hearing to have the Government disprove them.

In the case at bar appellant made no showing whatsoever to indicate the existence of wiretapping. Not a scintilla of evidence was submitted to the District Court for consideration. Moreover, the Government by the affidavit of Assistant United States Attorney, Frederick J. Woelflen, stated unequivocally for the record that wiretapping was not employed during the course of the investigation of appellant. (R. 28-30). Affidavits of the type filed here or similar thereto have been given weight in a number of cases. *United States v. Pardo-Bolland*, *supra*, at 475; *United States v. Casanova*, *supra*, at 657; *United States v. Weinberg*, *supra*, at 569; *United States v. Flynn*, *supra*, at 930; *United States v. Frankfeld*, *supra*, at 935-936.

Perhaps the most revealing facet of the record relative to appellant's allegations relative to wiretapping is disclosed in the complete absence of efforts to examine the Government agent in charge of the investigation of the appellant. This investigator, Special Agent Richard L. Budde, Intelligence Division, Inter-



nal Revenue Service, was called as a witness by the defense, and asked if he had been assigned to handle the investigation of the appellant for the Internal Revenue Service. Though questioned about another unrelated matter, he was not interrogated concerning the allegations raised by appellant in his motion to suppress. (Tr. 511D-511F.)

Subsequently, this same agent was called as a rebuttal witness by the Government (Tr. 511M); however, counsel for appellant again failed to interrogate Agent Budde concerning appellant's allegations. Presumably, counsel for appellant saw no reason to question the affidavit of Assistant United States Attorney Frederick J. Woelflen (R. 29), where he stated:

Further, your affiant personally conferred with a Special Agent of the Intelligence Division of the Internal Revenue Service on February 6, 1964, who had investigated the alleged interstate gambling activities of the defendant in Las Vegas, Nevada, and your affiant was advised by this agent that the Internal Revenue Service did not engage in nor employ any wiretapping activities in securing investigative leads and other information which resulted in the indictment of the defendant.

The record does not reflect that counsel for appellant ever urged any further facts for consideration by the Trial Court. At no time during trial did he make any effort to supply evidence which would provide the basis for a hearing.

Appellant cites *Hoffritz v. United States*, 240 F. 2d 109 (9th Cir. 1956) in support of his argument for a

hearing. In *Hoffritz* an issue was clearly raised concerning a question of whether fraud and trickery were used by the Government to obtain permission to examine certain books, records and other documents. It was clear that the issue could not be resolved by an examination of the several rounds of supporting and opposing affidavits filed in that case. Here no question of fact was presented. *Austin v. United States*, 297 F. 2d 356 (4th Cir. 1961), another case cited by the appellant is similar to *Hoffritz* in that it involved an issue as to whether deception was practiced on a taxpayer in order to obtain records for a criminal tax prosecution. A number of factual details were alleged with respect to the conduct of the agents, including specific statements allegedly made by the investigating agents. The decision merely holds that a hearing should be held if issues of fact are raised.

We agree with appellant that a hearing must be held if a question of fact is posed, but mere speculations of counsel, denied in specific terms by Government affidavits, do not raise such an issue. If appellant's moving papers entitled him to a hearing then any defendant would be entitled to a hearing on his own speculative allegations.

## **II. The Evidence Was Sufficient to Show a Knowing or Intentional Use of Interstate Wire Communication Facilities.**

In considering the evidence indicating that the appellant was aware of the interstate nature of telephonic communications with bettors it should first be noted that the testimony of the witness Hochfeld



clearly established that the appellant was fully aware of the criminality involved in taking bets over the telephone from points outside Nevada. Moreover, it was established clearly that the appellant had this knowledge in the fall of 1961, at or about the time Section 1084 was enacted. (Tr. 296: 14-22, 297: 1-18). Despite the foregoing, proof adduced from Government witnesses shows that the appellant never inquired as to the location of interstate bettors when they phoned him for the purpose of wagering. Moreover, it was clear that he did not attempt to discontinue his interstate pattern of betting with Adolph Schuman, Raymond Syufy, or others. Subsequent gambling transactions after the fall of 1961, and into 1962 and 1963, reflect this incriminating continuation of wagering. This collation of facts strongly indicates consciousness of guilt at the time of his telephone conversations with out-of-state bettors.

The record shows that Schuman was well known to the appellant as a San Francisco resident, one well established in business, and one which he was willing to carry on a credit betting arrangement with. These circumstances quite logically fall into the wide category of evidence from which the jury could infer knowledge of the location of his bettors. The logical inference is that the appellant knew the witness Schuman was calling from San Francisco where the defendant knew he resided and carried on a well known business. (Tr. 243-245). In connection with this point it should also be noted that since the defense made every effort to show that this witness was well known to the defendant, the jury could logically

assume that such an associate would have made known his location in Las Vegas, a city some hundreds of miles from San Francisco.\* The absence of such conversation logically indicates the opposite fact, that Schuman was phoning from the San Francisco area. Moreover, appellant admits at page twenty-seven of his brief that "the evidence tended to show in the instant case that specific phone calls were, in fact, accepted by appellant from the Bay area and that these telephone calls had to do with bets and betting."

The procedure used by Mr. Schuman when calling the appellant also tends to reflect this guilty knowledge. When the witness phoned from his office, his secretary placed the call to the appellant specifically, thus circumstantially indicating to the appellant that the calls emanated from the witness' office in the City of San Francisco. (Tr. 203: 10-12; 203: 19-5 n.p.; 205: 1-9). In placing calls to the appellant from his home in Hillsborough, California, the witness Schuman testified that he would call him specifically and that he did not dial direct. (Tr. 205: 10-17). The jury could well have inferred that the usual procedure with respect to person-to-person calls was followed.

An analysis of the testimony of this witness reveals Schuman's testimony to be particularly convincing. Here we are dealing with an experienced businessman well known to the appellant for many years. His demeanor and manner of testifying enhanced the value of his testimony and added weight to it. Though indi-

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\* Appellant's Opening Brief, p. 31.

cating a slight reluctance to testify against the individual he placed his numerous sports bets with, he nevertheless testified fully concerning Counts Seven and Nine. (Tr. 273: 19-14 n.p.; 274: 15-21; 274: 22-4 n.p.; 276: 15-5 n.p.; 258: 25-2 n.p.; 209: 7-6 n.p.).

It can only be added that any question concerning the credibility of this witness and others was properly one for members of the jury. In this regard attention is invited to the Court's language in *United States v. Gulotta*, 29 F. Supp. 947, 950 (D. C. W. D. Missouri 1939), *rev'd on other grounds* 113 F. 2d 683:

Certainly when facts are proved from which only one conclusion normally would be drawn (and 99 times out of one hundred it would be right) there is substantial proof of that conclusion.

In *Holland v. United States*, 348 U. S. 121, 138-139, (1954) the Supreme Court referred to the latter principle by noting that though the Government must prove every element of the offense charged beyond a reasonable doubt, it need not do so to a mathematical certainty.

At various points in his brief, counsel for the appellant infers that wagers with the witness Schuman were bets between old friends. He suggests that the bets were not taken seriously or that the fact they knew each other for such a long period excludes their bets from the terms of Section 1084(a). It is not the intention of the Government to extend discussion of this point unnecessarily. It is merely pointed out that the proof shows that the appellant operated a gambling

establishment, and an extensive illegal interstate gambling business, that he supplied expert wagering information on which bettors relied, and that all of the witnesses settled their gambling accounts with the appellant.

The operation described by the witnesses was clearly the operation of a bookie and oddsmaker. Moreover, the bets made were large bets, particularly those of the witnesses Schuman, Syufy, and Hochfeld, and they were numerous in number. (Tr. 266; Tr. 335-336; Tr. 285-288). They may have known each other well but this can be of no significance inasmuch as they would have had to know each other well to carry on illegal credit wagering transactions. Indeed it would have been unusual if they were not well acquainted with each other. On the basis of the foregoing it is submitted that the relationship of the witness Schuman to the appellant was simply one of bettor and bookie and well within the terms of Section 1084(a).

A similar pattern exists with the witness Syufy. The nature of appellant's close association with this witness is reflected in their extensive credit betting transactions. The jury would have had a firm basis for concluding that the appellant was well aware of Syufy's home and residence location. (Tr. 365: 6-15; 366: 8-16; 367: 4-5 n.p.; 346: 6-10).

Similar patterns also appear with respect to the witnesses Drossman and Hochfeld. There was proof with respect to each tending to indicate that the appellant was aware that they resided outside of Las Vegas and outside of the State of Nevada. This proof when considered together with the appellant's con-

sciousness of guilt manifested through Frank Hochfeld's testimony, the failure to inquire concerning the location of witnesses, the unusual brevity of the telephone conversations involved as related by the witness Syufy, and the overwhelming proof that the appellant supplied odds and carried on an extensive wagering business, offers substantial evidence that he was well aware of the interstate aspects of calls placed to him by the witnesses Schuman and Syufy in connection with transactions described in Counts Seven and Nine.

The Record also reflects clearly that the witness Syufy identified the appellant as the person with whom he was dealing at the Saratoga. The fact that he did not recognize the telephone voice he spoke to when phoning the Saratoga is immaterial in light of the clear and convincing testimony that this witness bet with the Saratoga over interstate facilities, that the only person he knew at the Saratoga was the appellant, and in view of the fact that he settled his wagering bills with the appellant only. It would be stretching credulity to say that the interstate betting of this witness was carried on with anyone other than the appellant. It must be noted that this witness was obviously hostile and biased. Despite this fact, Raymond Syufy did testify sufficiently to block out any possibility that he was dealing with anyone at the Saratoga other than the appellant.

At page twenty-one of appellant's brief it is asserted that appellant could have accepted "hundreds or even thousands of telephone calls concerning the subject of betting on the telephone within the State of



Nevada.” However, it is noted in this regard that Regulations promulgated by the Nevada Gaming Commission and Nevada Gaming Control Board specify that all bets accepted by race and sports books establishments in Nevada must be on an “over-the-counter basis, for cash . . . .” (Regulation 5.020). Presumably appellant was aware of the illegality of his conduct under Nevada law as well as the applicability of the prohibitions contained in Section 1084(a) of Title 18 United States Code. This additional factor also tends to indicate the absence of innocence in connection with appellant’s interstate wagering methods.

### **III. The Trial Court Did Not Err in Its Instruction to the Jury on the Issue of Criminal Intent.**

Appellant questions the Trial Court’s instruction to the jury relating to the subject of criminal intent. The portion questioned is set forth herein for the convenience of the Court:

Intent may be proved by circumstantial evidence. Indeed, it can rarely be established by any other means. While witnesses may see and hear and so be able to give direct evidence of what a defendant does or fails to do, of course there can be no eye witness account of a state of mind with which the acts were done or omitted. But what a defendant does or fails to do may indicate intent or lack of intent to commit the offense charged. As a general rule, it is reasonable to infer that a person ordinarily intends all the natural and probable consequences of acts knowingly done or knowingly omitted. So unless the evidence in the case leads the jury to a different

or contrary conclusion, the jury may draw the inference and find that the accused intended all the natural and probable consequences which one standing under like circumstances and possessing like knowledge should reasonably have expected to result from any act knowingly done or knowingly omitted by the accused. (Tr. October 5, 1965, pp. 43-44).

It is contended that reversible error is involved in the portion of the quoted instruction which states that it is reasonable to *infer* that an accused intends "all the natural and probable consequences" of his acts. Appellant asserts that the language used in this regard allowed the jury to presume appellant's guilty knowledge concerning the character of the interstate calls which he received.

It is extremely difficult to follow appellant's reasoning with respect to this point, particularly in light of the last sentence of the intent instruction, which specifically informed the jury that the Government retained the burden of proving that "the defendant knew that the use of . . . wire communication facilities for the transmission in interstate commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event was contrary to law." The instruction contained in the sentence last quoted was specifically requested by the appellant. (Tr. October 5, 1965, p. 44).

It should be noted that the "natural and probable consequences" portion of the instruction given in this case was substantially the same as one approved in *Sherwin v. United States*, 320 F. 2d 137 (9th Cir.



1963), *cert. denied* 375 U.S. 964, *petition for reh. denied* 376 U. S. 946. The specific language used in *Sherwin* is as follows:

It is reasonable to infer that a person ordinarily intends the natural and probable consequences of acts knowingly done or knowingly omitted. So unless the contrary appears from the evidence, the jury may draw the inference that the accused intended all the consequences which one standing in like circumstances and possessing like knowledge should reasonably have expected to result from any act knowingly done or knowingly omitted by the accused.

Despite the striking similarity of the quoted instruction to that given in this case, appellant argues that the instruction is more like that condemned in *Bloch v. United States*, 221 F. 2d 786 (9th Cir. 1955), *reh. denied* 223 F. 2d 297. The dissimilarity in the two instructions is immediately apparent inasmuch as the instruction in *Bloch* provided that: "The presumption is that a person intends the natural consequences of his acts, and the natural inference would be if a person consciously, knowingly and intentionally did not set up his income, and thereby the government was cheated or defrauded of taxes, that he intended to defeat the tax."

The *Sherwin* case specifically distinguished the two instructions set out, noting that there are definite differences. In *Sherwin* the instruction was general in nature, and the word "infer" was used rather than "presumption." The Court also noted that the instruction in *Bloch* was specific in that it was given in terms of the facts of that case. Here, as in *Sherwin*,

specific intent instructions were actually given to the jury and particular facts were not singled out as a basis for the jury to draw an inference of guilty intent.

The "natural and probable consequences" instruction given in this case is approved in large measure by the following language in *Cramer v. United States*, 325 U. S. 1, 31 (1945):

Since intent must be inferred from conduct, we think it is permissible to draw usual reasonable inferences as to intent from the overt acts. The law of treason, like the law of lesser crimes, assumes every man to intend the natural and probable consequences which one standing in his circumstances and possessing his knowledge would reasonably expect to result from his acts.

The principle is also enunciated in *United States v. Patten*, 226 U. S. 525, 543 (1913), and in *Agnew v. United States*, 165 U. S. 36, 53 (1897). Appellant disregards the cited authorities and then through a tortuous process of reasoning endeavors to apply the *Bloch* decision and other related authority to the facts in this case.

In this regard *Morissette v. United States*, 342 U. S. 246 (1951) is cited in support of his contention. However, in *Morissette*, unlike this case, the issue of criminal intent was erroneously withdrawn from the jury. In that case a presumptive intent instruction relative to the mere act of taking spent bomb casings from a Government bombing range precluded the jury from considering whether from all the evidence the defendant was guilty of a theft of Government property. Other authorities cited by appellant do not reflect the

pertinent law in this Circuit relative to the instruction given. *Sherwin v. United States*, *supra*; *Legatos v. United States*, 222 F. 2d 678 (9th Cir. 1955); *Bateman v. United States*, 212 F. 2d 61 (9th Cir. 1954). Moreover, the authorities cited by appellant on this point relate to the crime of willfully attempting to defeat or evade payment of income taxes, which crime necessarily involves proof of a negative. In such cases proof of specific intent is unusually significant by reason of the unique burden of proof imposed upon the Government. However, here we are dealing with the performance of affirmative criminal acts prohibited by law, rather than the omission to perform an act as required by law.

**IV. Authorities Pertaining to Section 4401(c) of Title 26 United States Code Relating to the Definition of Persons Liable for the Wagering Excise Tax Are Not Relevant for the Purpose of Interpreting Substantially Different Statutory Language Contained in Section 1084(a), Title 18 United States Code.**

Appellant argues that Section 1084(a) of Title 18 United States Code should be construed in a manner which would preclude prosecution of a substantial number of those engaged in the business of betting or wagering. This result was necessarily implied in jury instructions prepared by appellant to the effect that Section 1084(a) should be narrowly and strictly interpreted so as to make it applicable only to those persons who are proven to be principals in gambling operations. To reach the conclusion that the denial of such requests to charge the jury was error, appellant argues that Section 1084(a) should be restricted and

limited by authorities construing the phrase, "engaged in the business of *accepting* wagers," as the latter phrase, is used in Section 4401(c) of the Internal Revenue Code. Appellant's contention is not supported in the legislative history of Section 1084(a), and it would contradict pertinent case law on the subject. Moreover, there is no evidence in the case indicating that any of the Government witnesses ever dealt with the appellant other than as a principal.

In *Kelly v. Illinois Bell Telephone Company*, 210 F. Supp. 456 (N. D. Ill. 1962), *aff'd*, 325 F. 2d 148, Section 1084(a) was construed in connection with an injunction action brought against the Illinois Bell Telephone Company, which company had acted to halt telephone service under the provisions of Section 1084(d). The action of the Telephone Company followed receipt of notification from the United States Department of Justice that a publishing firm operated by the plaintiff was engaged in the business of receiving and transmitting gambling information in violation of law. At page 466 of the opinion the Court thoroughly discusses the applicability of Section 1084 (a) to the publications of the plaintiff and uses the following pertinent language:

Examination of the language of the section (Section 1084(a)) as well as its legislative history indicates beyond any doubt that Congress did intend to reach the activities of persons other than those directly accepting bets or wagers. There is considerable testimony in the hearings with respect to the complex nature of interstate gambling or sports events, particularly horse

racess, and the variety of activities involved over and above the mere receipt of bets from individuals.

Though the opinion notes that the conduct of the plaintiff did not constitute a violation of Section 1084 (a), it clearly recognized that it was the intention of the Congress to reach the activities of persons "engaged in the business of betting or wagering" other than bookies operating as principals only.

The phrase in question is set forth in Section 1084 (a) of Title 18, United States Code without qualification or condition. In *United States v. Smith*, 209 F. Supp. 907, 918 (U. S. D. C. E. D. Ill. 1962), the phrase was specifically construed and it was held that it is clear and unambiguous and that it may readily be understood by a simple reading of Section 1084. The words were characterized as being within the ordinary understanding and as such may be given their usual and accepted meaning. The instruction of the Trial Court on this point was in accord with the holding in *Smith*.

It is noted that no case annotated under Section 1084 contains authority for construing the phrase to apply to principals only, as counsel for the defendant suggests. It should also be noted that absent a specific congressional intent to include principals only, the words "engaged in business" should be given their ordinary meaning; and one who is occupied or employed in a business is "engaged" in it. *Lumber Mut. Casualty Ins. Co. v. Stokes*, 72 F. Supp. 463, 467 (D. C. S. C. 1947), rev'd on other grounds 164 F. 2d 571 (4th Cir. 1947).



The Trial Court's instruction as to the purpose of Section 1084(a) properly noted that the congressional intent of the statute was to assist the various states in the enforcement of their laws pertaining to gambling, bookmaking, and to aid in the suppression of organized gambling activities. (Tr. October 5, 1965, p. 40). *United States v. Yaquinta*, 204 F. Supp. 276, 279 (U. S. D. C. West Va. 1962). The proposed construction would diminish the assistance and suppression contemplated so as to make both insignificant.

That such a result would follow is inferred in appellant's brief at page thirty-four where it is noted that the legislative history of Section 1084(a) indicates that the measure was enacted because the wagering excise tax laws have proven to be a disappointment from the standpoint of curbing gambling activity. This factor alone indicates that the Congress anticipated Section 1084(a) to be more effective than the wagering excise tax statutes.

The difference in terminology used in the two sections is apparent. That is the phrase, "being engaged in the business of wagering," is broader in scope, than the more limited phrase, "engaged in the business of accepting wagers." Moreover, the latter is necessarily unique and distinct, by reason of the fact that taxing statutes are based upon considerations either not desirable or needed in other criminal statutes. With regard to the wagering excise tax, it should be noted that it was passed and constitutionally upheld as a revenue measure and not for other purposes. *United States v. Calamero*, 354 U. S. 351, 358 (1956); *United States v. Kahriger*, 345 U. S. 22, 28 (1953), *petition for reh. denied* 345 U. S. 931.



The difference in construing the federal wagering excise statutes, as distinct from gambling statutes, is vividly depicted in the following language in the specially concurring opinion of Circuit Judge Cameron in *Edwards v. United States*, 321 F. 2d 324, 327 (5th Cir. 1963)\*:

It cannot be mentioned too often that prosecutions such as these which we are reviewing are prosecutions for the violation of federal taxing laws, not for the violation of gambling laws, and, "in construing [the statutes] we would not be justified in resorting to collateral motives or effects [a congressional desire to suppress wagering] which, standing apart from the federal taxing power, might place the constitutionality of the statute in doubt. . . . In short, whether one gambles or not is of no concern to the federal government, except insofar as the taxing power is involved.

It is perhaps these limiting elements inherent in the wagering excise tax statutes which led to disappointment in their utilization as effective prosecutive tools to curb gambling activities. To engraft such weaknesses into Section 1084(a) as appellant suggests would clearly attenuate that provision and frustrate the primary objective of the Congress. It is submitted that since appellant's proposed instructions relative to "being engaged in the business of betting or wagering" erroneously limited the phrase to principals only, the Trial Court did not err in rejecting them.

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\* Reversed *en banc* on other grounds, 334 F. 2d 360 (5th Cir. 1964), *cert. denied*, 379 U. S. 1000.

Point V of appellant's argument concerning "social wagers," is closely related to the preceding discussions. It is asserted that defense instructions numbered eleven and seventeen should have been given to the jury to distinguish between "social wagers," and "business wagers." (Tr. October 5, 1965, pp. 50-52). However, both requests were erroneous and therefore properly denied.

Proposed instruction seventeen relates to factors which determine whether a wager is "taxable," and also contains language indicating that Federal wagering excise tax statutes are not applicable to the "social or friendly type of bet." Such an instruction would have been misleading and confusing in this case, based as it is on Section 1084(a). It should also be noted that both instructions would have had the effect of obfuscating the Court's charge with respect to the phrase, "being engaged in the business of betting or wagering" as set forth in Section 1084(a), in that both requests allude to the "business of *accepting* wagers," which language is essentially different from that contained in Section 1084(a).

Throughout appellant's brief an effort is made to characterize the appellant's relationship to his bettors in social terms. However, the evidence in the case clearly reflects that the appellant was engaged in the legal and illegal business of wagering on a full-time basis. The only testimony cited by appellant in this regard is that Adolph P. Schuman was known to the appellant for approximately thirty years. However, it is evident that a gambler must know

his customers in order to maintain a credit wagering relationship with them.

It is true that Section 1084 was not designed to be applicable to isolated acts of wagering by individuals not engaged in the business of wagering. However, this burden of proof was accurately described by the Trial Court, and thereby precluded the possibility of finding guilt without first determining that the appellant was engaged in the business of wagering.

The legislative history of Section 1084 clearly indicates that the purpose of the legislation was to curb the activities of the professional gambler. However, it also notes that the effect of the statute would be seriously attenuated if the professional gambler were allowed to escape prosecution by characterizing his gambling business as "social wagering." In this connection the testimony of former Attorney General Robert F. Kennedy before the Senate Committee on the judiciary is particularly pertinent.\*

Law enforcement is not interested in the casual dissemination of information with respect to football, baseball, or other sporting events between acquaintances. That is not the purpose of the legislation. However, it would not make sense for Congress to pass this bill and permit the professional gambler to frustrate any prosecution by saying, as one of the largest layoff bettors in the country has said, "I just like to bet. I just make social wagers."

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\* S. Report No. 588, to accompany S. 1656, 87th Congress, 1st Session.

**V. The Court Did Not Err in Its Instruction to the Jury That Every Person Is Presumed To Know What the Law Forbids and What the Law Requires to be Done.**

Appellant notes that the statute forming the basis of his conviction was only recently enacted by Congress and from this infers that it was error to instruct that everyone is presumed to know the law. Section 1084 was enacted on September 13, 1961. The acts charged in Counts Seven and Nine of the indictment occurred a year later during the football season of 1962. Moreover, there was positive proof introduced through the testimony of Frank Hochfeld that on or about the date of enactment the appellant was specifically aware of the criminality involved in his use of interstate wire communication facilities for wagering purposes. (Tr. 296-304).

In support of his position on this point he cites *Edwards v. United States*, 321 F. 2d 324, (5th Cir. 1963). However, the cited case was subsequently reversed *en banc*. *Edwards v. United States*, 334 F. 2d 360, *cert. denied* 379 U. S. 1000. The second *Edwards* opinion contains a thorough evaluation of the presumption in question. That case involved a prosecution under Section 7203 of Title 26, United States Code for wilfully failing to register for and pay gambling excise taxes as required by Sections 4411 and 4412 of Title 26, United States Code. The Court held that a rebuttable presumption of knowledge of the law exists. Interestingly, the holding in *Edwards* related to a crime involving the wilful *failure* to comply with specific duties imposed by statute. The opinion notes

that in such cases a showing of ignorance of the law would have been a complete defense. Here the charge involves the performance of an affirmative act and ignorance of the law would not be available as a defense. The following language at page 367 of the second *Edwards* opinion reflects the basis for the holding:

Where the law is plain, definite, and well settled, and any want of knowledge of its requirements is a fact resting peculiarly within the knowledge of the defendants, when the Government has established its case in all other respects, the burden of adducing *some* evidence to rebut the presumption of such knowledge rests on the defendants. A mental state being involved, the presumption of knowledge of the law is analogous to the presumption of sanity . . . (Citing authority).

The principle outlined and the instruction given in this case are supported in a number of well-known authorities. *Shevlin-Carpenter Co. v. Minnesota*, 218 U. S. 57, 68 (1909); *Turf Center, Inc. v. United States*, 325 F. 2d 793, 797 (9th Cir. 1963); *Elwert v. United States*, 231 F. 2d 928, 937 (9th Cir. 1956); *Finn v. United States*, 219 F. 2d 894, 899-900, (9th Cir. 1955), *cert. denied* 349 U. S. 906.

#### VI. Appellant's Cross-Examination of the Witness Adolph P. Schuman Was Not Improperly Limited.

Counsel for the appellant refers to what he terms a denial of his right to cross-examine the witness Schuman for the purpose of raising the question of a grant



of immunity. The record reflects clearly that counsel was given opportunities to inquire into this question, that he did unsuccessfully pursue such inquiry, and that while doing so he improperly attempted to read into the record a memorandum of an interview prepared by an Internal Revenue Agent in connection with an interview of the witness Schuman and his attorney. The memorandum was not signed, approved, or adopted by the witness Schuman, nor had he ever seen it.

The transcript reflects the following ruling of the Court relative to the statement in question:

THE COURT: All right, you can ask from it a question if you have something specific, did this occur or that occur, but Mr. Schuman isn't responsible for the preparation of this document. (Tr. 268: 23-1 n.p.).

After being permitted to inquire fully into the subject of immunity and receiving no satisfaction from the witness, counsel for appellant attempted to read the statement. (Tr. 269: 8-21). The Court then stated:

THE COURT: You can ask him from that statement what occurred at the meeting and get his statement of what occurred there, if it is relevant to any testimony that is before us. . . . (Tr. 270: 20-23).

Counsel then fully cross-examined the witness again and received no satisfaction. (Tr. 270: 25 to 272: 24). Subsequently at the conclusion of the trial the Government and counsel for appellant reached a stipulation concerning this point. The record reflects the following in this regard:



MR. FOSTER: It is my understanding that counsel will stipulate that on July 24, 1963, at San Francisco, California, in the office of Mr. Henry Robinson, Attorney at Law, in the presence of Mr. Henry Robinson, Mr. Adolph Schuman and Mr. L. H. Miller, that Mr. Schuman stated as follows:

Both Mr. Schuman and his attorney assured me that given the proper immunity, any information which they might have relating to our inquiry will be given completely and truthfully.

MR. KEENEY: I would so stipulate, your Honor. (Tr. October 5, 1965, p. 511L).

It is clear that the Court in no way interfered with appellant's right to cross-examine the witness Schuman on this point. Moreover, the information contained in the statement in question, though not properly elicited during cross-examination, was introduced by stipulation.

#### VII. Count Seven of the Indictment Was Not Duplicitous.

Appellant contends that an otherwise valid count in an indictment may become duplicitous by reason of information contained in a bill of particulars. There is no authority for such a novel conclusion of law. In fact it is well settled that an indictment may not be amended except by resubmission to the grand jury unless the change is merely a matter of form. *Russell v. United States*, 369 U. S. 749, 770-771 (1962); *Stirone v. United States*, 361 U. S. 212, 217 (1959); *Ex parte Bain*, 121 U. S. 1 (1887).

In this case appellant was supplied with the particulars that he specifically requested relative to Count

Seven for the purpose of aiding him to prepare his defense, prevent surprise, and to preclude the possibility of a second prosecution for the same offense. He now appears to be complaining that he was given an excess of information, or that there was an excess of evidence to prove Count Seven of the indictment.

The Seventh Count provided that during the football season of 1962, appellant being in the business of betting and wagering utilized interstate wire communication facilities to transmit information for the purpose of assisting in the placement of a wager on a San Francisco Forty-Niner football game. The Amended and Corrected Bill of Particulars apprised the appellant that this Count would be established by showing that the offense occurred during a number of telephone calls with the witnesses Schuman and Syufy. (R. 34-35).

The rule on duplicity in the Ninth Circuit has been aptly stated in *Empire Oil & Gas Corporation v. United States*, 136 F. 2d 868, at 872:

Duplicity in an indictment means the charging of more than one offense, not the charging of a single offense committed in more than one way. *Duplicity may be applied only to the result charged, and not to the method of its attainment.* (Emphasis supplied).

In *Travis v. United States*, 247 F. 2d 130, 134 (10th Cir. 1957)\*, the rule of duplicity is stated as follows:

“Duplicity” in an indictment generally means the charging of two or more separate and distinct

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\* *Rev'd on other grounds* 364 U. S. 631 (1961).

offenses in one count, not the charging of a single offense into which several related acts enter as ways and means of accomplishing the purpose.

The rule stated is also expressed in a number of other authorities. *United States v. Lennon*, 246 F. 2d 24, 27, (2nd Cir. 1957), *cert. denied* 355 U.S. 836 (1957); *Hanf v. United States*, 235 F. 2d 710, 715, (8th Cir. 1956), *cert. denied*, 352 U. S. 880 (1956); and *Mellor v. United States*, 160 F. 2d 757, 762, (8th Cir. 1947), *cert. denied* 331 U. S. 848.

In *Hanf* the following language was used with respect to a count charging conduct embracing a number of acts which individually might have been made the subject of separate counts:

Certainly, any similar prosecution by the government against this appellant for a violation committed at any time between the dates indicated in Count one of the indictment would be a prosecution for the same offense, and would be promptly dismissed. (235 F. 2d at 715).

In *Mellor* the Court noted that:

We know of no rule that renders an indictment duplicitous because it charges as one joint offense a single completed transaction instead of charging in separate counts as many offenses as the evidence at the trial might conceivably sustain. (160 F. 2d at 762).

The foregoing authorities indicate that duplicity is not created by the mere fact that the Government might have made each separate telephone call by each bettor a separate count. The offense arose out of appellant's illegal wagering business, and the method of pleading inured to the benefit of the appellant.

In *Korholtz v. United States*, 269 F. 2d 897, (10th Cir. 1959), *cert. denied* 361 U. S. 929, a corporate employer paid approximately \$2,300 to a labor union representative in violation of the Taft Hartley Act. The amount was paid in thirteen separate transactions. The union official was charged in a single count with the aggregate amount received. The Court rejected the duplicity contention and noted that:

The cases reveal that a complaint of duplicity is rarely made when but a single statutory prohibition is involved since the effect of joining several violations as one redounds to the benefit of defendant.

\* \* \* \*

The trial court committed no error in admitting evidence as to all payments made to the bank and in rejecting appellant's proposed instructions that the jury must limit its consideration to only the first of the series of payments made. The defendants were charged with a single offense and the government had no burden nor duty to limit its proof to or elect to stand upon a single transaction. (269 F. 2d at 901).

The indictment under consideration here clearly charged only one offense. Appellant should not be allowed to complain that proof of this offense was greater than that contemplated, particularly in this situation where he was apprised of the proof before trial.

Counsel for appellant takes the position that the testimony of the witness Syufy does not support the allegations of the indictment in any particular. It is abundantly clear from a review of the testimony of

this witness that the position taken has no basis. The testimony was admissible to prove allegations in Count Seven. This testimony was also relevant and properly submitted to the jury in connection with that general element of proof requiring that the Government establish that the defendant was engaged in the business of betting and wagering. It was also material and relevant with respect to the defendant's criminal intent in dealing with bettors. As previously noted herein in connection with discussion of the testimony of the witnesses Schuman and Syufy, there was sufficient specific evidence relating to Count Seven to warrant submission of their testimony to the jury.

At page forty-two of appellant's brief a number of authorities are cited for the purpose of inferring error in the submission of the testimony of Schuman and Syufy to the jury. However, in the cases cited error was found because of the submission of an erroneous legal theory for consideration in the evaluation of evidence. Here there is no question of an erroneous charge in connection with the testimony of these two witnesses. Their statements were properly submitted to the jury for evaluation, and the mere fact that appellant is not aware of the weight attributed to the evidence cannot be significant. The jury might have rested its verdict with respect to Count Seven on the testimony of Schuman or Syufy, or both.



**VIII. The Trial Court Did Not Err in Admitting the Testimony of Soll C. Drossman, Frank Hochfeld and Henry Wayne Stead.**

The introduction of the testimony of Soll C. Drossman, Frank Hochfeld and Henry Wayne Stead was properly allowed in this case to show that the appellant was an individual "engaged in the business of betting or wagering" within the meaning of Section 1084(a). It is well established that where proof of other criminal acts aids in, or is a necessary aspect of, establishing the crime charged, such evidence is admissible. *Schwartz v. United States*, 160 F. 2d 718, 721, (9th Cir. 1947); *Gianotos v. United States*, 104 F. 2d 929, 932-933, (9th Cir. 1939). The testimony was also admissible to show the intent and knowledge of the appellant in his dealings with Adolph P. Schuman and Raymond Syufy over interstate telephone communication facilities. *Reid v. United States*, 334 F. 2d 915, 918, (9th Cir. 1964); *Stewart v. United States*, 311 F. 2d 109, 112, (9th Cir. 1962); *Corey v. United States*, 305 F. 2d 232, 239, (9th Cir. 1962), *cert. denied* 371 U. S. 956 (1962). It is also well settled that subsequent similar acts may have probative value. *Anthony v. United States*, 256 F. 2d 50, 53, (9th Cir. 1958); *United States v. Blount*, 229 F. 2d 669, 671, (2nd Cir. 1956). The testimony of each of these witnesses was legally sufficient for the two purposes outlined.

In this case proof of appellant's wagering business was essential. It would not have been possible to establish the offense charged without showing elements of his gambling activities. In a similar man-



ner the evidence of other interstate gambling transactions was circumstantially probative in determining that the appellant was aware of the interstate features of dealing with customers located outside the State of Nevada. In this regard it is noted that the testimony of the witness Hochfeld was admissible for the additional reason that it specifically established appellant's knowledge of the criminality involved in his activities. Appellant's brief appears to ignore this conclusive proof of guilty knowledge, as well as other proof of knowledge of the location of bettors.

The testimony of the witness Stead was stricken by the Court on motion of the appellant. An appropriate instruction to disregard Stead's testimony was thereafter given to the jury. (Tr. October 5, 1965, pp. 511A-511B; Tr. October 5, 1965, p. 35). However, an examination of legal authorities cited indicates that it would not have been prejudicial to submit Stead's testimony to the jury as being admissible on the question of intent and knowledge, as well as in further proof that appellant was engaged in the business of betting and wagering. The testimony of the witness Drossman was admissible to show appellant's complicity in a similar interstate wagering relationship conducted between Las Vegas, Nevada, and Tucson, Arizona. The testimony of the witness Hochfeld was admissible to show direct proof of appellant's knowledge, and also appellant's complicity in another interstate wagering relationship conducted between Las Vegas and Portland, Oregon.

Appellant cites six cases in support of his theory concerning the testimony of these three witnesses.

*Kraft v. United States*, 238 F. 2d 794, (8th Cir. 1956), clearly recognizes the principles of law which allows proof of other crimes on the question of intent. However, in *Kraft* the proof of other acts amounted to unsupported accusations consisting of letters of complaint printed in a newspaper. *Paris v. United States*, 260 Fed. 529, 531, (8th Cir. 1919), involved proof of an arrest in another district in connection with a narcotics offense. These cases cannot be equated with the instant prosecution where the proof of other interstate wagering activity was clear, certain and convincing.

*Mora v. United States*, 190 F. 2d 749, (5th Cir. 1951), is not in point on the question, and the language quoted in appellant's brief as emanating from this decision does not appear to form a part of that opinion. *Wiley v. United States*, 257 F. 2d 900, (8th Cir. 1958), involved the affirmance of a Mann Act conviction. In *Wiley* reputation evidence that the defendant was a "panderer" was introduced and then stricken. The Court held that this did not constitute error. Moreover, the decision recognized the probative value of other acts of transportation, as well as acts of physical harm perpetrated on the defendant's victims. *Sang Soon Sur v. United States*, 167 F. 2d 431 (9th Cir. 1948) is not in point, inasmuch as the error related to proof of a narcotics offense in an income tax evasion prosecution. Similarly, *Boyd v. United States*, 142 U. S. 450 (1892) would not be pertinent since it involved evidence of a defendant's complicity in certain robberies to prove a murder charge.

## CONCLUSION

Appellant has established no legal or evidentiary basis for a hearing on his pretrial motion to suppress and other contentions raised relating to rulings of the Trial Court are without merit. Evidence at the trial established clearly that while in Las Vegas, Nevada, appellant maintained wagering relationships over interstate telephone facilities with bettors in San Francisco, California; Portland, Oregon; and Tucson, Arizona, and that he regularly conducted wagering activity in the City of Las Vegas, Nevada, in a gambling establishment known as the Saratoga Sports Book. In connection with the San Francisco facet of appellant's wagering business it was established that appellant performed the acts described in Counts Seven and Nine of the indictment. On the basis of the foregoing it is submitted that the conviction should be affirmed.

Respectfully submitted,

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## CERTIFICATE OF APPELLEE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

LOUIS SCALZO  
*Attorney,*  
*Department of Justice*



No. 20,807

United States Court of Appeals  
For the Ninth Circuit

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LESLY COHEN,

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

APPELLANT'S REPLY BRIEF

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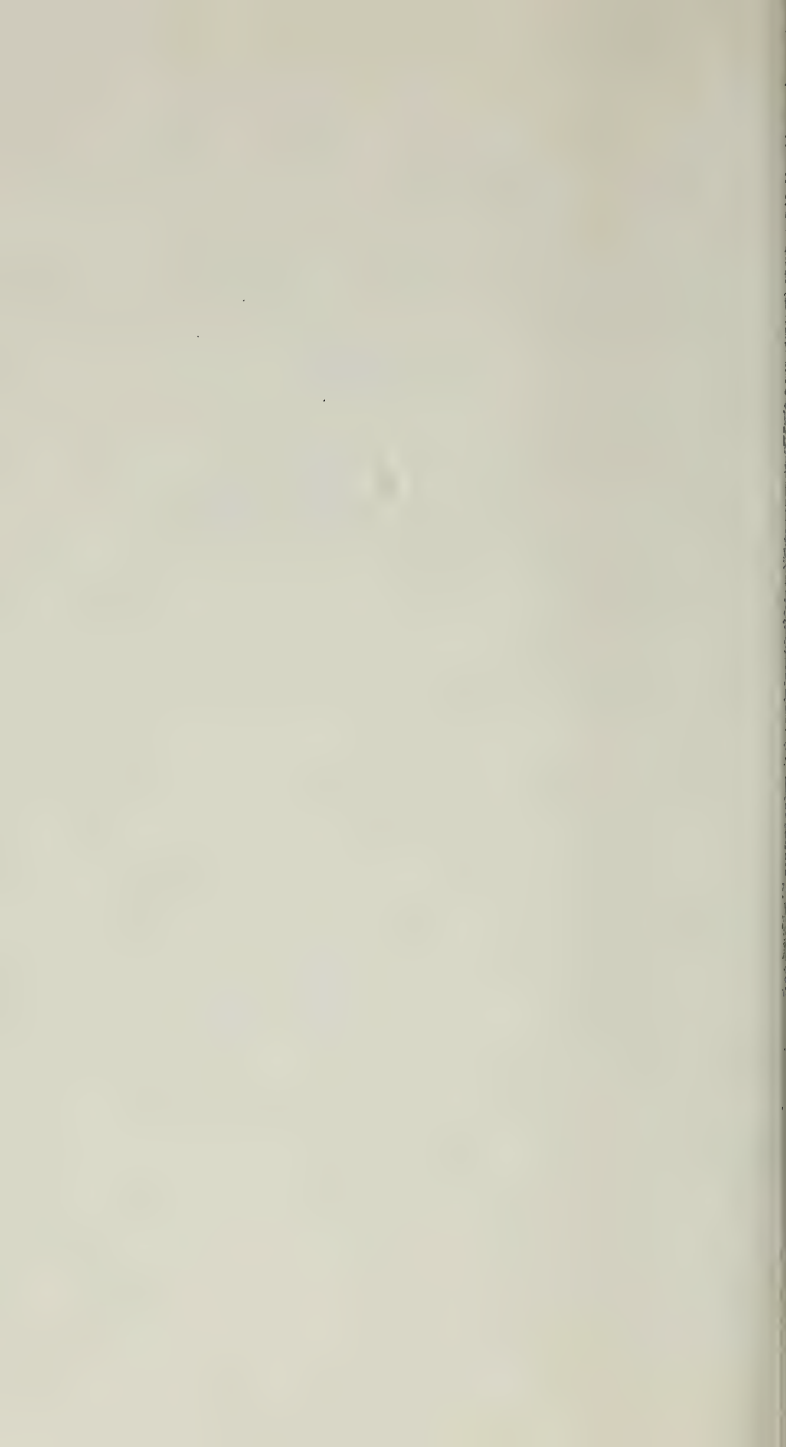
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No. 20,807

# United States Court of Appeals For the Ninth Circuit

LESLEY COHEN,

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

## APPELLANT'S REPLY BRIEF

### I. A HEARING ON THE MOTION TO SUPPRESS SHOULD HAVE BEEN GRANTED.

We will not discuss the general principles with respect to the interception of mail by the Government in this Reply Brief since we feel the issue between the Government and ourselves on whether a so-called mail watch is legitimate has been adequately covered in our Opening Brief. We do feel, however, that we should answer the Government's contentions with respect to a denial of any hearing at all on the Motion to Suppress.

The Government criticizes our affidavit and infers that this was the only evidence before the Court on the question of mail tampering or wire tapping. We do not believe that it is possible to make any stronger

showing by affidavit than the one made by us without the confessions of Government agents who were actually involved in the proceedings themselves. A Government employee who admits knowledge of illegal activity on the part of the Government naturally faces the possibility of retaliation by his superiors. A defendant in a criminal case is hardly in a position to offer the protection necessary to convince such an employee to step forward by way of affidavit or otherwise. Only by the process of compulsory testimony at a jurisdiction hearing can such an employee practically be expected to testify. Here, counsel had interrogated persons contacted by the Government. The testimony of these persons indicated a familiarity on the part of Government agents with the contents of telephone conversations and mail. Counsel simply requested an opportunity to interrogate the agents with respect to their knowledge of the contents of telephone conversations and mail matter. This opportunity was denied by the Court. But in addition, in the present case the only thing before the Court was not the affidavit of counsel. Here, the Government itself filed affidavits and admitted tampering with the defendant's mail. The only thing denied in the Government's affidavits is the extent to which it engaged in the practice. We submit that once the smoke of such an admission rolls across the record, counsel should be given an opportunity by examination under oath to determine what fire was the cause.

It is impossible for us to conceive any legitimate reason why the Government should oppose an inquiry

into the facts surrounding the mail watch. If the Government had nothing to hide it should welcome inquiry. In the instant case there was no question of interrupting a trial with respect to a collateral issue. The Motion to Suppress was timely made and an examination of the witnesses could not be said to be an undue burden on the time and facilities of the United States District Court.

We are somewhat puzzled by one argument by the Government with respect to the denial of the hearing. Government counsel seems to imply that no attempt was made to re-introduce the question at the trial. Since arrangements were made with counsel for the Government with respect to the very witnesses subpoenaed at the Motion to Suppress at the trial of the case. Counsel for the Government must be aware that these witnesses were subpoenaed at the trial and aware that Judge Wollenberg had advised counsel he intended to follow Judge Harris's rule and preclude inquiry into wiretapping or mail tampering. TR 508; TR 44. Counsel was precluded from inquiring as to the leasing of telephone lines by the Federal Government. TR 44. In its cross-examination of the Nevada Telephone Company employee, the Court actually said at page 508 of the transcript that with respect to renewing a Motion to Suppress, "It will be denied as it was previously."

In this connection it should be noted that in other judicial proceedings the Government has admitted tapping wires in Las Vegas. As we recall, as developed in *Hoffa v. United States*, at least twenty-nine tele-



phone lines were tapped by the Government. Whether the defendant here was one of the twenty-nine, could not be established because the Court would not allow the Government to be questioned on the subject.

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## II. EVIDENCE WAS INSUFFICIENT TO SHOW KNOWLEDGE.

We think the argument of Government counsel with respect to sufficiency of the Government to establish knowledge can be most accurately characterized from the Government brief at page 32: "The absence of such conversation logically indicates the opposite fact, that Schuman was phoning from the San Francisco area."

In other words, the Government in the Court of Appeals as it did in the Court below, is attempting to affirmatively prove knowledge from a lack of evidence.

A knowledge of the location of the caller in a criminal case which requires proof beyond a reasonable doubt cannot be proved by a failure of the defendant to inquire as to the caller's location. The Government has accused the defense of speculation with respect to the Motion to Suppress. Here, however, the Government is inviting the Court of Appeals to engage in the vaguest kind of speculation to supply the affirmative evidence required by the criminal law. The burden is on the Government to prove that the defendant did know from where the call was placed, not that he should have known or should have inquired concerning the witnesses' location.

Here, the witnesses used to prove the Government's case had all been in Las Vegas and had business interests there. The conviction ultimately rested on one telephone call. We submit that this Court cannot affirm on the grounds that the conversation did not include an assertion by Mr. Schuman that he was in Las Vegas. In order to prove knowledge, the Government must prove that Schuman said or otherwise indicated that he was in the San Francisco area.

The Government makes some assertions concerning the manner of the call. It is extremely unclear as to whether or not they are claiming the manner of placing the call somehow indicates the call was to the knowledge of the defendant a long distance call. If the Government had any such evidence they would have introduced it.

We are sure the Court is aware of the difference between a long distance station-to-station call and a person-to-person call. No proof was ever established here to prove a person-to-person call. Schuman's language cannot be tortured into a statement that such was the case. If there had been an operator on the line, that fact would have been developed. It was not. The record clearly shows that there was no indication in the conversation or manner of placing the call which could have reasonably indicated to Mr. Cohen that either Mr. Schuman or Mr. Syufy were calling from out of State.

### III. THE COURT ERRED ON ITS INSTRUCTIONS TO THE JURY ON THE ISSUE OF INTENT.

In discussing the instruction objected to by the defense on intent, the Government relies almost entirely on the case of *Sherwin v. United States*, 320 F.2d 137. Counsel for the defense is quite familiar with that case. We submit that this Court in *Sherwin v. United States* never approved the instruction but simply indicated in the circumstances there present it would not reverse.

The Supreme Court denied certiorari in the *Sherwin* case but on the same date it also refused certiorari in a case in which the Court reversed on an identical instruction. *Mann v. United States*, 319 F.2d 404 cert. denied 375 U.S. 964.

We submit that the rule is clear in this Circuit with respect to this instruction. See *Forester v. United States* (9th Cir.) 237 F.2d 617. Here, the crucial issue for the jury was intent depending upon the proof of knowledge of Schuman's location at the time of the call. The jury was allowed to presume this intent from the fact that a call was actually made from San Francisco. We submit that such an instruction requires reversal here.

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### IV. THE WAGERING EXCISE TAXES STATUTE AND SECTION 1084 SHOULD BE CONSTRUED TOGETHER.

We should advise the Court that *Costello v. United States*, 34 LW 2278, is being argued before the Supreme Court this week. The case involves the con-

stitutionality of the Wager Tax Law and may very well involve the Court in a discussion concerning the various efforts of the Federal Government to regulate gambling. Insofar as it does so, the Court's decision may bear on the interpretation of Section 1084. Whether a social bet among friends can constitute such a burden on interstate commerce as to allow the Federal Government constitutionality to regulate it conceivably could be determined by the decision in the *Costello* case.

The Government's contention that the two statutes are unconnected, we think untenable. The legislative history indicates just the contrary. The only difference pointed to by the Government between the statutes is the bland assertion that "the business of wagering" is broader than "the business of accepting wagers." To us, we can see no difference other than grammar between the two phrases. What we are dealing with is two felony statutes, both of which we believe should require like principles.

The language in the objected to instruction incorporated another provision of the Internal Revenue Code, that is to say, Sections 4411 and 4412, which ultimately imposes misdemeanor penalties on one engaged in wagering "on behalf of" another person.

The Court grafted this misdemeanor situation onto the provisions of Section 1084. We believe that Congress in providing the more extreme penalty intended to limit prosecution to misdemeanors. Otherwise this misdemeanor language "on behalf of" would have been engrafted in the provisions of Section 1084. We

do not believe such a requirement can be added by judicial fiat.

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#### V. THE EXAMINATION OF SCHUMAN WAS IMPROPERLY LIMITED.

The Government answers our objection that cross-examination was improperly limited with respect to Schuman's request for immunity by asserting that the examination was *not limited*. It does so by indicating the record quotations where the statements of Mr. Schuman were incorporated in the record. What the Government fails to point out is that this stipulation was not introduced before the *jury* but simply introduced to indicate to the Court of Appeals that Mr. Schuman had, in fact, requested immunity. The Court did not allow Schuman to be questioned on this request in the presence of the jury. It is for this reason error is urged here.

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#### VI. THE GOVERNMENT HAS CHANGED ITS CONTENTION WITH RESPECT TO DROSSMAN, HOCKFELD AND STEAD.

At the trial the Government introduced the testimony of the above named witnesses for the sole and limited purpose of proving intent. The Court gave with the Government approval a limiting instruction. They now claim that the evidence was introduced to prove that Appellant was in the business of wagering. This, we believe, they cannot do at this late date.

The testimony must stand or fall on whether it properly showed proof of intent and, in this connec-

tion, as we indicated in our opening brief, the testimony was not probative. The testimony was simply a hodge-podge of vague statements about gambling and telephone calls before the effective date of Section 1084. It was introduced on the basis that there were similar offenses. The proof, however, did not show similar offenses. The testimony was therefore prejudicial and should require reversal.

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#### VII. CONCLUSION.

We have not answered the Government's contention with respect to the presumption of knowledge of the law and duplicity, for the reason we believe that these and other matters urged are adequately covered in our Opening Brief.

Here, the appellant has been convicted of a felony or a casual wager with a social acquaintance of thirty years standing with not a scintilla proved to show that he knew he was engaged in an interstate phone call.

In our opinion, this kind of conduct in the circumstances of this case is not criminal and, in view of the errors committed at the trial, the conviction should be reversed.

Dated, San Francisco, California,  
October 14, 1966.

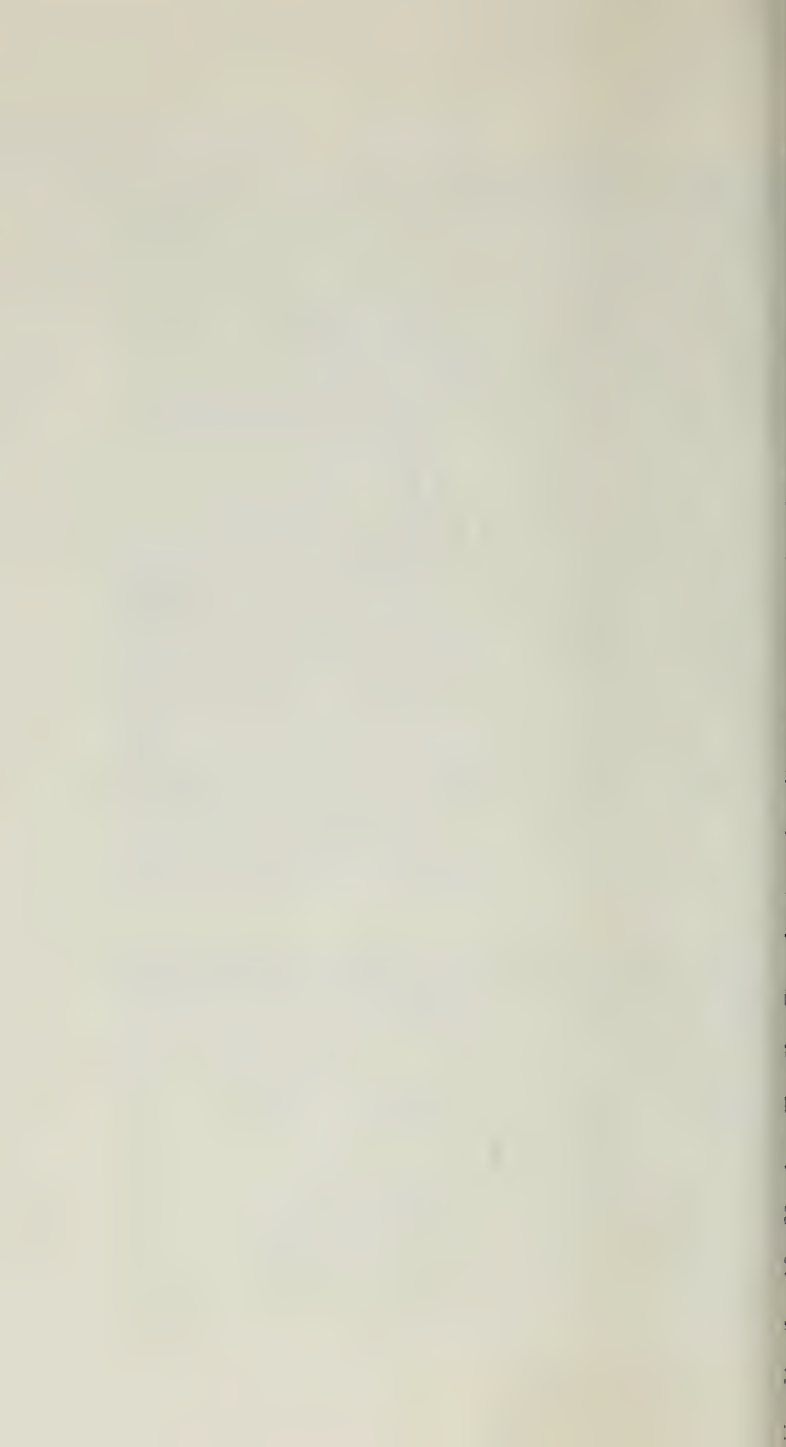
Respectfully submitted

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3 No. 20811 ✓

4 IN THE  
5 UNITED STATES COURT OF APPEALS  
6 FOR THE NINTH CIRCUIT  
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9 JACK GOODMAN, PARAMOUNT ICE CREAM ( )  
10 CORP. and FRIGID PROCESS CO., ( )  
1 Appellants, ( )  
2 vs. ( )  
3 UNITED STATES OF AMERICA, ( )  
4 Appellees. ( )  
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11 APPELLANTS' OPENING BRIEF  
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2 IN THE  
3 UNITED STATES COURT OF APPEALS  
4 FOR THE NINTH CIRCUIT  
5  
6

7 JACK GOODMAN, PARAMOUNT ICE CREAM (   
8 CORP. and FRIGID PROCESS CO., )   
9 vs. Appellants, )   
10 UNITED STATES OF AMERICA, (   
11 Appellees. (   
12

---

13 APPELLANTS' OPENING BRIEF  
14

15 JURISDICTIONAL STATEMENT

16 On November 8, 1965 a complaint was filed in the  
17 United States District Court for the Southern District of  
18 California, Central Division wherein appellants, relying  
19 on the Fourth, Fifth and Sixth Amendments to the  
20 Constitution of the United States and pursuant to Rule  
21 41(e) of the Federal Rules of Criminal Procedure and  
22 28 U.S.C., Section 1331(a), sought the return of property  
23 or copies thereof and the suppression for use as evidence  
24 of various books, records and memoranda which, it was  
25 alleged, were obtained by appellees as the result of an  
26 unlawful search and seizure conducted in and around



1 Los Angeles, California, within the jurisdiction of said  
2 court. (C.T.2)<sup>1</sup> Hearings were held on December 6, 1965,  
3 December 15, 1965, December 16, 1965 and January 6, 1966.  
4 On February 8, 1966 a final judgment was entered by the  
5 Court which adjudged that appellants' rights under the  
6 Fourth, Fifth and Sixth Amendments to the Constitution  
7 had not been violated and appellants' complaint was dismissed  
8 (C.T. 256.) On February 11, 1966, appellants filed a  
9 Notice of Appeal (C.T. 267). This Court has jurisdiction  
10 to review the final judgment of the District Court under  
11 Title 28, United States Code, sections 1291 and 1294.

#### 12 STATEMENT OF THE CASE

13 In these proceedings, appellants are seeking  
14 the return of property, or copies thereof, which it is  
15 contended was obtained from them in violation of the  
16 Fourth, Fifth and Sixth Amendments to the Constitution of  
17 the United States.

18 Special Agent Frederick Nielsen was formally  
19 assigned to conduct a criminal tax investigation of  
20 "Jim Pinkerton" on March 2, 1964. (Exhibit 8.) On April 7

---

21  
22 <sup>1</sup>Throughout this brief, references to the  
23 Clerk's Transcript will be designated by "C.T.", and  
24 references to the Reporter's Transcript will be designated  
25 by "R.T."  
26





1 1964, Mr. Nielsen, accompanied by Special Agent David  
2 Stutz, first contacted Mr. Pinkerton. They did not  
3 advise Mr. Pinkerton that they were criminal investigators  
4 or that they were conducting an investigation of a  
5 criminal nature because he did not ask. (R.T. 20-21.)  
6 Later the same day the agents went to Paramount Ice  
7 Cream Corp. (hereinafter "Paramount"). They briefly  
8 identified themselves to Ruth Myshrall, the bookkeeper,  
9 and told her they were investigating Mr. Pinkerton and  
10 Paramount and that Mr. Pinkerton said that the records of  
11 Paramount were available for their examination. (R.T.21-22.)

12 They returned the next day and displayed their  
13 credentials to Mr. Goodman who had acquired control of  
14 Paramount from Mr. Pinkerton in March, 1962. (R.T. 416, 455)  
15 The District Court found that Mr. Goodman asked the  
16 difference between a special agent and a revenue agent  
17 even though they were both special agents and their  
18 identification commissions were identical and that  
19 Mr. Nielsen explained the difference. (C.T. 249.)  
20 Mr. Nielsen testified that he explained that:

1 ". . .an Internal Revenue Agent conducts  
2 civil audits; a Special Agent conducts an  
3 investigation to determine whether any of  
4 the Internal Revenue laws have been violated,  
5 whether there has been any attempt to evade  
6 or defeat the payment of any income taxes."



1 (R.T. 24.)

2 No statement, however, was made that the agents were con-  
3 ducting an investigation of a criminal nature. (R.T. 417-418)

4 Mr. Goodman testified that although Paramount and  
5 Frigid Process Co. (hereinafter "Frigid") had been once  
6 audited in the past, he never had any dealings with any of  
7 the agents conducting those audits. He denied asking Mr.  
8 Nielsen and Mr. Stutz the difference between special agent  
9 and revenue agents. He testified that the first time he  
10 learned that there was a difference between revenue agents  
11 and special agents was during the first week of January,  
12 1965. (R.T. 298-299.)

13 On April 8, 1964 Mr. Nielsen and Mr. Stutz were  
14 shown various records of Paramount for the years 1959  
15 through 1962. According to Mrs. Myshrall, the agents  
16 wanted to see Paramount's books only up to March of 1962;  
17 the time when Mr. Pinkerton sold his interest in Paramount  
18 to Mr. Goodman. (R.T. 210, 211, 212.) Mr. Nielsen testified  
19 that Mr. Goodman was not advised of any constitutional  
20 rights at this meeting because he was not then the subject  
21 of an investigation. (R.T. 28, 30.)

2 The agents returned to Paramount on April 9, 1964  
3 and April 21, 1964, when they continued to examine and copy  
4 records of Paramount. On April 21, 1964, the agents were  
5 permitted to take with them books and records of Paramount  
6 all of which, except for one, related to the period up to



1 and including 1962. (Exhibit 1.) The Court found that  
2 certain books beyond 1962 were taken. (C.T. 250.)

3 On October 23, 1964, Mr. Nielsen and Mr. Loebig  
4 contacted Mr. Charles Fisher, the accountant for Paramount.  
5 Mr. Pinkerton and Mr. Goodman. (R.T. 80.) On the document  
6 receipt issued to Mr. Fisher (Exhibit 5), Mr. Nielsen's  
7 title of "Special Agent" was omitted.

8 Prior to November 6, 1964, Mr. Nielsen discussed  
9 Mr. Goodman with his group supervisor and obtained his  
10 approval to requisition Mr. Goodman's personal income tax  
11 returns for his taxable years 1959 through 1963 (Exhibit 9).  
12 These returns were requisitioned on November 6, 1964 and  
13 November 10, 1964, as part of an "official investigation".  
14 Mr. Nielsen stated that he requisitioned these returns to  
15 determine whether Mr. Goodman had reported as income a  
16 particular commission which had been paid to him according  
17 to Paramount's books and records. (R.T. 55.) Mr. Nielsen  
18 testified that Mr. Goodman reported this item of income on  
19 his return. (R.T. 62.)

20 On December 18, 1964, Mr. Nielsen returned to  
21 Paramount, this time accompanied by Internal Revenue  
22 Agent Keith Loebig. The purpose of the agents returning  
23 was to examine the books and records of Paramount for  
24 the period subsequent to March, 1962, the approximate  
25 time when Mr. Goodman bought out the interest of  
26 Mr. Pinkerton in Paramount. (R.T. 85, 87, 210, 211, 212,





1 214.) On this visit, the agents had in their  
2 possession Mr. Goodman's personal returns, but these  
3 returns were not shown to him on this date. (R.T. 446.)  
4 Mr. Goodman was not advised of any of his constitutional  
5 rights on December 18, 1964. (R.T. 62, 450.) The agents  
6 knew that the books and records which they examined and  
7 obtained on December 18, 1964, pertained to a period  
8 when Mr. Goodman was president of Paramount. (R.T. 455.)  
9 On December 18, 1964, they obtained Paramount's post-1962  
10 records and issued a document receipt which indicates that  
11 the material was submitted in re "Jim Pinkerton".  
12 (Exhibit 2.)

13 After leaving Paramount on December 18, 1964, at  
14 approximately 3:00 or 4:00 P.M., Mr. Nielsen testified he  
15 then returned to his office where he discussed several  
16 of his cases with his supervisor. He also discussed  
17 Paramount, Mr. Pinkerton and Mr. Goodman, and it was  
18 decided in this conversation that Mr. Goodman would become  
19 the subject of an investigation. (R.T. 54, 63, 64.)  
20 (Exhibit 8.)

1 The agents returned to Paramount on December 21,  
2 1964. According to Mr. Nielsen's testimony, he told  
3 Mr. Goodman that in the past their conversations pertained  
4 to Mr. Pinkerton and Paramount, but that now they were  
5 investigating his personal returns. Mr. Nielsen testified  
6 that his advice to Mr. Goodman was as follows: that he was



1 a Special Agent with the Intelligence Division, United States  
2 Treasury Department; that Mr. Goodman was not required to  
3 make any statement that may tend to incriminate him; that  
4 any statement he made could be used against him; and that  
5 he had the right to legal counsel. (R.T. 68-69.) The  
6 agents testified that at no time, however, did they tell  
7 Mr. Goodman that they were conducting a criminal investi-  
8 gation and at no time was the word "crime" or any other word  
9 of similar import used. (R.T. 68, 450, 454.) Mr. Nielsen  
10 testified that this meeting took approximately one hour.  
11 (R.T. 69.)

12 Mr. Goodman categorically denied that the agents  
13 advised him of any of his constitutional rights or that he  
14 was the subject of an investigation. (R.T. 305-306.) On  
15 this day the agents had Mr. Goodman identify his personal  
16 returns and they asked him to produce his personal  
17 cancelled checks. (R.T. 69, 73, 74.) Mr. Goodman testified  
18 that he believed the agents' request for his cancelled  
19 checks was part of their continuing investigation of  
20 Mr. Pinkerton, since he had been doing business with  
21 Mr. Pinkerton for 27 years. (R.T. 306.) Mrs. Myshrall  
22 testified that Mr. Goodman told her after this meeting that  
23 the agents wanted to see his cancelled checks pertaining  
24 to dealings with himself and Mr. Pinkerton. (R.T. 217.)  
25 According to Mr. Goodman and Mrs. Myshrall, the agents  
26 remained with Mr. Goodman for no more than five minutes.



1 (R.T. 213, 307.) The Court's findings are substantially  
2 in accord with Mr. Nielsen's testimony. (C.T. 251.)

3 After this meeting with Mr. Goodman, the agents  
4 remained at Paramount for the balance of December 21, 1964  
5 microfilming records. (R.T. 60, 70.) Upon leaving  
6 Paramount this day, the agents took with them various  
7 other records of Paramount for which they issued a document  
8 receipt. Even though they allegedly told Mr. Goodman  
9 that they were now investigating him, and they took records  
0 relating to the period after 1962, the document receipt  
1 states that the records were submitted in re "James  
2 Pinkerton". The records taken were "a total of ten (10)  
3 brown, light, books containing duplicate copies of deposit  
4 tickets for Paramount Ice Cream Co. from January 23,  
5 1961 through June 2, 1964." (Exhibit 3.)

6 On December 23, 1964, the agents returned to  
7 Paramount at which time they obtained Mr. Goodman's cancelled  
8 checks. (Exhibit 4.) Mr. Nielsen testified that he did  
9 not warn Mr. Goodman of any of his constitutional rights  
0 other than telling him "that he was not obligated to turn  
1 these checks over". (R.T. 76, 78, 460.) The District  
2 Court so found (C.T. 251.) Mr. Goodman categorically  
3 denied that he was told that he could refuse to turn over  
4 his checks to the government. (R.T. 308.)

5 Mr. Nielsen and Mr. Loebig first went to Frigid  
6 on December 30, 1964 and returned on January 4, 5, 6 and 7,



1 1965 during which they examined Frigid's books and record  
2 (R.T. 97, 98.)

3 On January 8, 1965, a meeting took place between  
4 Mr. Nielsen, Mr. Loebig and Mr. Goodman. When Mr. Nielse  
5 was asked if he told Mr. Goodman that the investigation  
6 was of a criminal nature, he stated that the only  
7 explanation he gave Mr. Goodman about the nature of the  
8 investigation was that "I was investigating his own  
9 personal returns and that's all the further explanation  
10 I made". (R.T. 102.) There was a sharp conflict in the  
11 testimony concerning the details of this meeting. The  
12 Court found that the agents' version of the meeting was  
13 correct. (C.T. 252.)

14 Mr. Loebig testified that the first time in the  
15 investigation that Mr. Nielsen had ever used the word  
16 "criminal" was during this meeting when Mr. Nielsen  
17 stated that he felt the criminal aspects of the case had  
18 priority over the civil aspects of the case. (R.T. 453.)  
19 Mr. Loebig further stated that Mr. Goodman had never been  
20 told this prior to January 8, 1965. (R.T. 454.) He  
21 testified that prior to this meeting on January 8, 1965,  
22 he had no idea whether Mr. Goodman understood that he and  
23 Mr. Nielsen were conducting a criminal investigation.  
24 (R.T. 443.)

25 Mr. Loebig testified that he took notes of the  
26 meetings on December 21, 1964, January 8, 1965, and Janua





12, 1965. He did not take notes of meetings held on  
December 18, 1964 and December 23, 1964. (R.T. 457, 461.)  
Both Mr. Nielsen and Mr. Loebig testified that they  
refreshed their recollections of the meetings with  
Mr. Goodman by examining their notes or memoranda of  
these meetings. (R.T. 387, 456.) None of these notes  
or memoranda were ever submitted to the Court. Mr. Loebig  
further testified that the primary concern of the  
investigation that he and Mr. Nielsen were conducting  
was to "determine whether there have been any criminal  
violation of the Internal Revenue laws". (R.T. 442.)

In the course of the District Court proceedings  
subpoenas duces tecum were served upon various appellees.  
(C.T. 179-87.) On January 6, 1966, appellees' motion to  
quash these subpoenas was granted. (R.T. 400-01.) On  
January 27, 1966, an Order for Findings of Fact,  
Conclusions of Law, and Judgment was entered by the  
Court wherein it was held that appellants' rights under  
the Fourth, Fifth and Sixth Amendments had not been  
violated. (C.T. 246.) Thereafter, proposed Findings of  
Fact, Conclusions of Law, and Judgment were lodged by  
appellees on February 2, 1966 and were signed by the  
District Court and entered on February 8, 1966. (C.T. 248-  
258.)

\* \* \* \* \*



SPECIFICATIONS OF ERROR RELIED UPON

1. The District Court erred in granting appellees' motion to quash appellants' Subpoenas Duces Tecum, dated December 14, 1965.

2. The District Court erred in making Findings of Fact VIII, X, XI, XII, XIII, XIV, XVII, XIX, XXII, and XXIII as set forth below:

A. Finding of Fact VIII is erroneous in that Mr. Goodman did not ask the difference between a special agent and an Internal Revenue agent and further because Mr. Nielsen did not explain the difference.

B. Finding of Fact X is erroneous because only one book beyond 1962 was taken by the agents.

C. Finding of Fact XI is erroneous because Mr. Nielsen wanted to examine the post-1962 Paramount books and records as part of an investigation of appellants.

D. Finding of Fact XII is erroneous because Mr. Nielsen was assigned to investigate Mr. Goodman prior to his visit to Paramount on December 18, 1964.

E. Finding of Fact XIII is erroneous because the investigation of appellants began on December 18, 1964; Mr. Goodman was not told of his constitutional rights in a meaningful fashion; Mr. Goodman was not told that he was not obligated to turn over his personal cancelled checks; Mr. Goodman did not voluntarily agree to make available the books of Frigid Process Co.; Mr. Nielsen did not ask



1 Mr. Goodman for permission to examine additional records of  
2 Paramount as part of the Pinkerton-Paramount investigation;  
3 Mr. Nielsen did not take books of Paramount with him on this  
4 day as part of the Pinkerton-Paramount investigation.

5 F. Finding of Fact XIV is erroneous because  
6 on December 23, 1964 Mr. Nielsen did not tell Mr. Goodman  
7 that he did not have to turn over his personal cancelled  
8 checks.

9 G. Findings of Fact XVII is erroneous because  
10 on January 8, 1965 Mr. Goodman did not invoke his right  
11 against self-incrimination; Mr. Nielsen did shout;  
12 Mr. Nielsen did promise leniency; Mr. Nielsen did accuse  
13 Mr. Goodman of lying; Mr. Goodman did not initiate a  
14 discussion with the agents thereafter on that day.

15 H. Finding of Fact XIX is erroneous because  
16 on January 12, 1965 the agents did not give a receipt for  
17 certain books and records of Frigid which were taken on that  
18 day.

19 I. Finding of Fact XXII is erroneous in  
20 its entirety.

21 J. Finding of Fact XXIII is erroneous in its  
22 entirety.

23 K. Conclusions of law 2 through 5 are  
24 erroneous in their entirety.

25 \* \* \* \* \*

26





1                                    SUMMARY OF ARGUMENT

2                    During the trial, appellants sought to obtain,  
3 by the use of subpoenas duces tecum, various material which  
4 they felt was critical to the presentation of their case.  
5 The District Court, without stating any reasons, granted  
6 appellees' motion to quash said subpoenas. Since appellants  
7 were entitled to said material and since said material  
8 was critical to appellants' case, the action of the District  
9 Court denied appellants due process of law.

10                    During the course of a criminal income tax  
1 investigation of appellants, which originally began as  
2 a criminal tax investigation of a third party, various  
3 books, records and memoranda of appellants were obtained  
4 and copied by appellees for use in future criminal  
5 proceedings. Appellants contend that the criminal investi-  
6 gators obtained such evidence in violation of their rights  
7 under the Fourth, Fifth and Sixth Amendments. Accordingly,  
8 all material so obtained must be suppressed as evidence  
9 in any future proceedings and all copies thereof must be  
0 returned to appellants.



1 ARGUMENT

2 I.

3 THE TRIAL COURT ERRED IN GRANTING APPELLEES' MOTION TO  
4 QUASH THE SUBPOENAS DUCES TECUM

5 A. A Subpoena Duces Tecum Will Only Be Quashed  
6 If It Is Oppressive and Unreasonable.

7 Under Rule 45(b) of the Federal Rules of Civil  
8 Procedure, a subpoena may be quashed if it is both unreason-  
9 able and oppressive. Fed. R. Civ. P. 45(b).

10 In the Court below, appellees argued that the  
11 scope of appellants' original subpoenas duces tecum (C.T.  
12 259-266) was too broad and, consequently, unreasonable and  
13 oppressive. Appellants thereupon modified the subpoenas  
14 which had been served on Frederick Nielsen, Keith M. Loebig  
15 and Robert H. Lund, and significantly limited the material  
16 which appellants sought to have produced. (C.T. 179-87).  
17 The modified subpoenas sought the following information:

18 Item 1. The government agents' notes and  
19 reports of interviews or discussions with Jack Goodman and  
20 the bookkeepers of Paramount and Frigid for the period  
21 April 7, 1964 through June 10, 1965;

22 Item 2. The notes and reports of conferences  
23 or discussions between the government agents and their supe-  
24 visors pertaining to the commencement, progress and conduct  
25 of the investigation of Pinkerton, Goodman, Paramount and  
26 Frigid;



1 Item 3. The Internal Revenue Service manuals  
2 pertaining to the commencement and conduct of fraud investi-  
3 gations, including the procedural steps required, as well as  
4 requirements pertaining to the admonition by agents to per-  
5 sons being investigated of their constitutional rights;

6 Item 4. Any policy memoranda and adminis-  
7 trative rulings of the San Francisco Region and the Los  
8 Angeles District Director's Office pertaining to paragraph 3

9 Item 5. The work diaries of the two govern-  
10 ment agents involved for the period March 2, 1964 through  
11 January 14, 1965; and

12 Item 6. The work attendance records of the  
13 two government agents involved for the period December 18,  
14 1964 through January 14, 1965. (C.T. 179-187).

15 B. The Subpoenas Duces Tecum Are Not Oppressive.

16 The request for the documents and manuals in  
17 the modified subpoenas is, on its face, not oppressive  
18 since it does not seek the production of any books, ledgers  
19 or other bulky or weighty material. The request merely  
20 seeks notes, memoranda, reports and manuals. Appellees  
21 have failed to demonstrate that the subpoenas constitute  
22 an oppressive burden. Pursuant to Rule 45(b), appellants,  
23 at the trial, offered to pay the reasonable cost of  
24 producing such items. (R.T. 15).

25 C. The Subpoenas Duces Tecum Are Not Unreasonable

26 A careful examination of the particular papers



1 documents, and manuals sought and an examination of the  
2 arguments urged by appellants, indicates that the material  
3 sought was not only far from being unreasonable, but was  
4 relevant and critical to the establishment of appellants'  
5 case.

6 Appellants' position, both at the Trial Court  
7 and upon this appeal, is, to a great extent, founded upon  
8 the following two arguments:

9 1. That appellants were the "accuseds" in a  
10 criminal investigation and that they should have been timely  
11 advised of this fact and of certain constitutional rights;  
12 and

13 2. That the investigating agents intention-  
14 ally deceived and tricked appellants with respect to the  
15 subject and nature of the investigation and of their  
16 constitutional rights.

17 An explanation of the materiality of the  
18 documents sought is as follows:

19 Item 1. The notes, memoranda and reports  
20 of interviews would materially assist appellants in  
21 refuting the contention of the government agents that an  
22 admonition of constitutional rights was in fact given. In  
23 seeking such notes, appellants are not concerned with the  
24 substantive tax matter contained therein. Although there  
25 was testimony from the agents that notes were taken, they  
26 were never produced.





1                   Item 2. In seeking the notes, memoranda and  
2 reports of conferences and discussions between the various  
3 investigating agents and their supervisors and superiors,  
4 appellants sought the files pertaining to the status (rather  
5 than the substantive content) of the two investigations  
6 involved, both of which were greatly intertwined and inter-  
7 related. It is crucial that appellants be permitted to  
8 demonstrate the exact time when the investigation first  
9 included Mr. Goodman. Such material will also assist  
10 appellants in proving that fraud and deceit was practiced  
11 by the government agents since appellants believe that such  
12 notes and reports will demonstrate that Mr. Goodman was the  
13 subject of a criminal investigation prior to December 21,  
14 1964.

15                   Items 3 and 4: In seeking Internal Revenue  
16 Service manuals and policy memoranda or administrative  
17 rulings, appellants believe that these documents will be of  
18 material assistance in demonstrating that this investigation  
19 which was commenced by one or more special agents, was a  
20 criminal investigation from its inception and was never  
21 concerned with anyone's civil tax liabilities. Additionally  
22 the instructions to special agents contained in such manuals  
23 will lend support to testimony on appellants' behalf that  
24 no warning of constitutional rights was given.

25                   Items 5 and 6: The work diaries and work  
26 attendance records of the investigating agents were sought



1 for impeachment purposes. The government agents testified  
2 that a meeting was held during the late afternoon of  
3 December 18, 1964 with Mr. Nielsen's group chief, at which  
4 meeting the decision to begin an investigation of  
5 Mr. Goodman was reached. (Exhibit 8). Appellants contend  
6 that the decision to make Mr. Goodman the subject of a  
7 criminal investigation occurred sometime prior to  
8 December 18, 1964 and that the case assignment sheet (dated  
9 December 18, 1964) (Exhibit 8) was actually prepared prior  
10 to the interview of Mr. Goodman on this day. The  
11 production of the work diaries and work attendance records  
12 of the investigating agents hopefully will enable  
13 appellants to demonstrate this.

14 D. There Is Substantial Authority For The  
15 Production Of The Documents Sought.

16 There is substantial authority to support  
17 the production of the material requested in appellants'  
18 subpoenas duces tecum. In a most recent case, United States  
19 v. Gower, \_\_\_\_\_ F. Supp.\_\_\_\_\_, 65-2 USTC ¶15,655 (M.D. Pa.  
20 1965), the court ordered the Internal Revenue Service to  
21 produce for the taxpayer's examination not only all of the  
22 evidence obtained during the investigation but also all of  
23 the Service's inter-office reports, memoranda, and Internal  
24 Revenue manuals. See also United States v. Lipshitz, 150  
25 F. Supp. 321 (D.C.N.Y. 1957).

26 In United States v. Foley, 283 F.2d 582



(2d Cir. 1960), the Second Circuit approved the production of reports, memoranda and letters within the Internal Revenue Service concerning the taxpayers involved so that the court could determine whether they contained material to which the taxpayers were entitled.

In United States v. San Antonio Portland Cement Co., 33 F.R.D. 513 (W.D. Tex. 1963), the government was ordered to produce for inspection certain intra-office reports, memoranda and other statements and communications of the Internal Revenue Service, and the government's argument that the documents had executive or attorney-client privilege status was brushed aside.

E. The Appellees Had The Burden To Establish The Oppressive Or Unreasonable Nature Of The Subpoenas Duces Tecum.

This Circuit has previously held that the burden of quashing a subpoena on the grounds that it is oppressive and unreasonable is upon the person to whom the subpoenas are directed. Sullivan v. Dickson, 283 F.2d 725 (9th Cir. 1960).

F. Appellants Have Been Denied Due Process Of Law

At the trial, appellants had in their possession very little documentary evidence with which to corroborate their testimony. Appellants maintain that all of the documents sought in the subpoenas duces tecum would have been instrumental in demonstrating the veracity of





1 appellants' testimony and falsity of such of appellees'  
2 testimony. The District Court failed to state the grounds  
3 for quashing the subpoenas and failed to make a finding  
4 that they were unreasonable or oppressive. Since appellants  
5 were denied a material and significant method of establish-  
6 ing their case, they were denied due process of law.

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Appellants, therefore, request that this case be remanded to the District Court with a direction that all of the material sought in the subpoenas duces tecum be presented for appellants' examination and that, if warranted, additional evidence be received.

## II.

### THE GOVERNMENT AGENTS INTENTIONALLY DECEIVED AND MISLED APPELLANTS INTO BELIEVING THAT THEY WERE NOT THE SUBJECTS OF A CRIMINAL INVESTIGATION

#### A. The Use Of Fraud Or Deceit Nullifies The Admissibility Of Evidence So Obtained.

This Court has previously recognized that the presence of "affirmative fraud" on the part of government agents is sufficient to cause the suppression of any and all evidence, statements and books and records, thereby obtained. Kohatsu v. United States, \_\_\_ F.2d \_\_\_ (9th Cir. 1965) cert. den. \_\_\_ U.S. \_\_\_ (1966). That fraud or deceit violates the Fourth Amendment to the Constitution and constitutes sufficient grounds for suppression of evidence thereby obtained is not a new doctrine. It was originally stated by the Supreme Court in Gouled v. United States, 255 U.S. 298 (1920), and was recently affirmed in Miranda v. Arizona, 34 U.S.L. Week 4521 (U.S. June 13, 1966)

#### B. This Investigation Originally Pertained To A Third Party Only.

Since this investigation originally commenced



1 as an investigation of James Pinkerton (R.T. 9, 17) and,  
2 thereafter shifted to include Mr. Goodman (R.T. 67-68),  
3 manifest confusion as to the nature and subject of the  
4 various investigations was inherent. Since Mr. Goodman was  
5 president of Paramount during the time both of these inves-  
6 tigations were conducted, this confusion was obvious to the  
7 investigation agents. It was difficult, if not impossible,  
8 for an outsider to ascertain the exact function of the  
9 government agents on any given day. In fact, the subject  
10 of the investigation on any given day was likewise obscure.

11 C. The Inherent Confusion Was Purposely  
12 Compounded By The Agents.

13 The government agents compounded this confu-  
14 sion by failing to disclose, in any meaningful fashion, the  
15 subjects and nature of the various investigations. By  
16 referring to themselves merely as "special agents" or  
17 "internal revenue agents" (R.T. 24, 38, 67), and by pur-  
18 posely explaining their function in a legalistic rather  
19 than a meaningful fashion, they deliberately attempted to  
20 capitalize upon this confusion and uncertainty.

21 Appellants' confusion might have been elimi-  
22 nated had his accountant, Charles Fisher, been apprised of  
23 the fact that this was a criminal investigation. As an  
24 accountant, Mr. Fisher was one of the few people who was  
25 capable of appreciating the distinction between the two  
26 types of agents. On the document receipt given to Mr.



1 Fisher, Mr. Nielsen omitted his title of "Special agent."  
2 Although there were five other document receipts in evidence  
3 all of which were given to laymen, this was the only document  
4 receipt which omitted Mr. Nielsen's title.

5 The first document receipt was issued on  
6 April 21, 1964, and stated that the investigation was in re  
7 "Jim Pinkerton" (Exhibit 1). The document receipt of  
8 December 18, 1964, the day appellants contend the investi-  
9 gation of Mr. Goodman commenced, stated that the documents  
10 were given in re "Jim Pinkerton" (Exhibit 2). On  
11 December 21, 1964, the very day appellees allege that  
12 Mr. Goodman was advised that he was the subject of a  
13 criminal investigation and was requested to produce his  
14 personal cancelled checks, the document receipt was also  
15 issued in the name of James Pinkerton (Exhibit 3). An  
16 examination of this document receipt reveals that it per-  
17 tained to post-1962 deposits of Paramount. These items  
18 could only have remotely pertained to Mr. Pinkerton's  
19 investigation since Paramount was no longer owned by him  
20 after this time. Rather, this information must have been  
21 part of either the Goodman investigation or a post-1962  
22 Paramount investigation. Notwithstanding this, all of  
23 the document receipts issued through December 21, 1964  
24 were in the name of Pinkerton. The only reason for this  
25 was to keep Mr. Goodman deceived and confused.

26 D. The Agents Made No Attempt To Eliminate





1 The Confusion.

2           The government agents never used the word  
3 "criminal" or explained to Mr. Goodman that the investi-  
4 gation was criminal in nature until January 8, 1965. By  
5 this time, all of appellants' records were in appellees'  
6 possession.

7           It is submitted that the government agents  
8 purposefully and intentionally undertook a massive scheme  
9 of deception so that at every opportunity, they purposely  
10 compounded their deception and appellants' confusion. The  
11 agents purposely and consistently failed to make a meaning-  
12 ful explanation of their function or of the subject of the  
13 investigation. An example of Mr. Nielsen's efforts to keep  
14 appellants confused is aptly set forth at page 68 of the  
15 Reporter's Transcript. The document receipts added to the  
16 purposeful confusion.

17           It is submitted that pursuant to the authori-  
18 ty contained in Kohatsu, Gouled and Miranda, any and all  
19 statements made, books and records obtained, and copies of  
20 such books and records, were obtained from appellants in  
21 violation of the Fourth Amendment and therefore, should be  
22 suppressed as evidence in any future criminal proceeding.  
23 In addition, any and all copies of this material must  
24 likewise be returned to appellants.

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1 III.

2 THE FINDINGS OF FACT AND CONCLUSIONS OF LAW ARE  
3 CLEARLY ERRONEOUS

4 Appellants object to the following findings of  
5 fact:

6 "VIII

7 "Both [Mr. Nielsen and Mr. Stutz] displayed their commissi  
8 to Mr. Goodman. Mr. Goodman asked about the difference  
9 between a Special Agent and an Internal Revenue Agent.  
10 Mr. Nielsen explained the difference."

11 "X

12 "Certain books beyond 1962 were taken [on April 9, 1964 by  
13 Mr. Nielsen and Mr. Stutz]. . . ."

14 "XI

15 "On December 18, 1964, Mr. Nielsen returned to  
16 Paramount with Internal Revenue Agent Keith Loebig, to  
17 continue the Pinkerton-Paramount investigation. . . .  
18 Mr. Nielsen asked for other books and records of Paramount  
19 generally for the period subsequent to 1962, because Jim  
20 Pinkerton had continued to have transactions with Paramour  
21 subsequent to that date."

22 "XII

23 "After returning from Paramount on December 18,  
24 1964, Special Agent Nielsen was given a preliminary assign  
25 ment on Mr. Goodman so as to conduct a personal interview  
26 of Mr. Goodman concerning his affairs."



"XIII

"The preliminary investigation began on December 21, 1964. . . .He was told that he had a right against self incrimination, that he had a right to have an attorney present, that anything he said could be used against him. Mr. Goodman stated that he understood his rights, and identified six personal income tax returns. Special Agent Nielsen asked Mr. Goodman if he would voluntarily produce his personal cancelled checks, and informed Mr. Goodman that he was not obligated to do so. Mr. Goodman agreed to make said checks available. Mr. Goodman also agreed to make available the books of Frigid Process Co., South Pasadena and Las Vegas, which were kept at Frigid Process Co., South Pasadena, premises, and the date agreed on for this purpose was December 30, 1964.

"Special Agent Nielsen also asked Mr. Goodman for permission to examine additional records of Paramount as part of the Pinkerton-Paramount investigation. Mr. Goodman gave such permission and asked his bookkeeper to make available to the Agents any books and records they wanted to see. Mr. Nielsen took more books of Paramount with him concerning the Pinkerton-Paramount investigation and again left a receipt, which stated their names and titles."

"XIV

"Mr. Goodman produced his personal cancelled checks [December 23, 1964], after being again told by Mr. Nielsen





1 that he did not have to turn them over."

2 "XVII

3 "Mr. Goodman was again informed [on January 8, 1965] of his  
4 right against self-incrimination, and of his right to an  
5 attorney. During this meeting he invoked his right against  
6 self-incrimination. Mr. Nielsen did not shout; did not  
7 promise leniency, and did not accuse Mr. Goodman of lying  
8 . . . .Later the same day, Mr. Goodman returned to the area  
9 where the two Agents were working and initiated a discussion  
10 of some of the matters discussed previously in the earlier  
11 interview."

12 "XIX

13 "On January 12, 1965, they [the agents] saw Mr. Goodman,  
14 and Mr. Goodman stated that he had not decided yet whether  
15 to engage an attorney or not. On January 12 the agent were  
16 permitted to take with them certain books of Frigid. They  
17 left a receipt for said books, signed by both of them and  
18 showing their titles. It was made out 'In Re Jack Goodman  
19 and Frigid Process Co.'"

20 "XXII

21 "No fraud, deceit, concealment or misrepresentation  
22 was committed by any of the defendants to obtain for  
23 examination, copying and taking any of plaintiffs' books,  
24 records and documents."

25 "XXIII

26 "Permission was given voluntarily by plaintiffs



1 to defendants to examine, copy and take plaintiffs' books,  
2 records and documents."

3 Appellants object to the following conclusions  
4 of law:

5 "2. No rights of any of the plaintiffs were  
6 violated under the Fourth Amendment to the United States  
7 Constitution.

8 "3. No rights of any of the plaintiffs were  
9 violated under the Fifth Amendment to the United States  
0 Constitution.

1 "4. No rights of any of the plaintiffs were  
2 violated under the Sixth Amendment to the United States  
3 Constitution.

4 "5. That defendants are entitled to judgment  
5 herein."

6 Appellants object to the foregoing findings of  
7 fact on the grounds that each finding is controverted by  
8 the testimony of Mr. Goodman and third-party witnesses,  
9 Evelyn Gedatus and Ruth Myshrall. In addition, many of the  
0 findings are demonstrably false by reason of their in-  
1 consistency with other evidence, all which is set out in  
2 full in the following argument. When viewed in light of the  
3 heavy burden which must be overcome by appellees in the  
4 area of waiver of constitutional rights, these findings  
5 and conclusions of law must be set aside.

6 A. The Findings Of Fact Are Not Entitled To



1 Full Weight.

2 Under Rule 52 of the Federal Rules of Civil  
3 Procedure, findings of fact of a Trial Court shall not be  
4 set aside unless clearly erroneous. Fed. R. Civ. P. 52.  
5 The Supreme Court has defined the term "clearly erroneous"  
6 as follows:

7 "A finding is 'clearly erroneous' when  
8 although there is evidence to support it,  
9 the reviewing court on the entire evidence  
0 is left with the definite and firm con-  
1 viction that a mistake has been committed."

2 United States v. United States Gypsum Co.,  
3 333 U.S. 364, 395 (1948).

4 The findings of fact proposed by appellees  
5 were adopted in haec verba by the District Court and were  
6 entered six days after being lodged. (C.T. 248-54.)  
7 Appellants made no objections to the proposed findings since  
8 they feared that if protracted hearings were held on  
9 objections, this appeal could have rendered moot by an  
0 intervening indictment. Hoffritz v. United States, 240 F.2d  
1 109, 111 (9th Cir. 1956). At various times during the trial  
2 counsel for the appellees refused to guarantee the status  
3 quo even during the trial proceedings itself so that  
4 several restraining orders were necessary. (C.T. 156, 173  
5 190.) Since the findings of the court represented the  
6 complete adoption of appellees' proposed findings, they are



1 not entitled to the same weight as findings and conclusions  
2 actually prepared by the Trial Court. Roberts v. Ross,  
3 344 F.2d 747, 751-52 (3rd Cir. 1965); United States v.  
4 Howard, \_\_\_\_ F.2d \_\_\_\_, 17 AFTR 2d 900 (3rd Cir. 1966.)

5 B. The Findings Of Fact And Conclusions Of Law  
6 Are Against The Weight Of Evidence And Are Clearly  
7 Erroneous.

8 The findings of the District Court and the  
9 conclusions of law are clearly erroneous and are against  
0 the weight of the evidence due to the sharp conflicts in  
1 the testimony concerning the advising of constitutional  
2 rights and the numerous inherent testimonial inconsistencies.  
3 Since a person under investigation is always at a dis-  
4 advantage if for no other reason, than there are usually  
5 two government agents testifying that the individual was  
6 properly advised of his constitutional rights, a detailed  
7 examination of the most significant areas of testimonial  
8 inconsistency is vital. 8 Moore's Federal Practice §41.07[2]

9 1. Mr. Nielsen testified that Mr. Goodman  
0 questioned Mr. Stutz and him at their initial meeting about  
1 the difference between special agents and revenue agents.  
2 (R.T. 24.) It apparently is appellees' position that  
3 Mr. Goodman was the one individual in a hundred who knew  
4 of this distinction even though both of the agents con-  
5 fronting him were special agents. Even if Mr. Pinkerton  
6 contacted Mr. Goodman after Mr. Pinkerton's initial meeting





1 With Mr. Nielsen and Mr. Stutz the previous day,  
2 Mr. Pinkerton did not know the nature of the investigation.  
3 According to Mr. Nielsen, he did not tell Mr. Pinkerton  
4 that he was conducting a criminal investigation because  
5 Mr. Pinkerton had not asked. (R.T. 20-21.) It is  
6 incredible that Mr. Goodman, one who had never met an  
7 internal revenue employee prior to this time, was  
8 sophisticated enough in this complicated area to asked  
9 about the difference.

10 2. Mr. Nielsen and Mr. Loebig contacted  
11 Mr. Charles Fisher, the accountant for Mr. Goodman,  
12 Mr. Pinkerton and Paramount, and obtained certain of his  
13 records pertaining to Mr. Pinkerton and Paramount. (R.T. 80.)  
14 Mr. Nielsen's claim that it was only inadvertence which  
15 caused him to omit his title from the document receipt given  
16 Mr. Fisher is questionable. (Exhibit 5.) Since there has  
17 been no testimony that there was ever a meaningful  
18 identification of Mr. Nielsen to Mr. Pinkerton, it is  
19 submitted that Mr. Nielsen's failure to properly identify  
20 himself was probably to prevent such information from  
21 getting back to Mr. Pinkerton by a public accountant, one  
22 of the few persons to whom the distinction between a  
23 revenue agent and a special agent was meaningful. Of the  
24 six document receipts in evidence, this is the only one  
25 where Mr. Nielsen's title was omitted.

26 3. Mr. Nielsen testified that pursuant to



1 prior approval of his group supervisor, he requisitioned  
2 Mr. Goodman's personal income tax returns as part of an  
3 "official investigation" on November 6, 1964 and  
4 November 10, 1964. (R.T. 61; Exhibit 9.) Mr. Nielsen  
5 then testified that his sole purpose in requisitioning  
6 these returns was to determine whether Mr. Goodman properly  
7 reported a particular item of income. (R.T. 55.) Even  
8 though Mr. Nielsen concluded that the item had been  
9 properly reported he nevertheless decided to formally  
10 investigate Mr. Goodman. Mr. Nielsen testified that after  
11 his visit to Paramount on December 18, 1964, he returned  
12 to his office and discussed the case with his group super-  
13 visor. (R.T. 54.) The meeting with his group supervisor  
14 was necessarily very brief since Mr. Nielsen testified  
15 that after leaving Paramount at 3:00 or 4:00 P.M., he  
16 first returned the government car and then discussed various  
17 unrelated cases with his supervisor. (R.T. 53.)  
18 Presumably, the drive from Burbank to the Federal Building  
19 in Los Angeles during a Friday evening rush hour must have  
20 taken at least a half an hour and possibly longer. Since  
21 Mr. Nielsen's working hours were 8:45 A.M. to 4:45 P.M.,  
22 it is doubtful that he discussed this matter at any great  
23 length, if at all. It is submitted that Mr. Nielsen had  
24 decided to investigate Mr. Goodman prior to this meeting  
25 which he allegedly had with his supervisor.

26 4. Mr. Nielsen's testimony that the only



1 reason he limited his examination of Paramount's books  
2 in April, 1964, to transactions for the years 1959 to 1962  
3 was so as not to inconvenience the bookkeeper, (R.T. 41,)   
4 was refuted by Mrs. Myshraill. (R.T. 226.) She testified  
5 that examination of post-1962 books and records would not  
6 have been inconvenient. More importantly, she stated  
7 Mr. Nielsen told her that he was only interested in  
8 Paramount's books for the time when Paramount was owned by  
9 Mr. Pinkerton. (R.T. 212, 215.)

10 5. Mr. Nielsen testified that on December 21,  
11 1964, after asking Mr. Goodman to identify his personal  
12 income tax returns, he fully advised him that his returns  
13 were now being investigated and that he possessed certain  
14 constitutional rights. (R.T. 68.) Mr. Goodman denied  
15 that he was warned of his constitutional rights on this  
16 day or that he was told he was now the subject of a  
17 criminal investigation. (R.T. 303-06.) Rather, he  
18 testified that he was told he was being questioned as part  
19 of the continuing investigation of Mr. Pinkerton, an  
20 individual with whom he had had extensive business dealings  
21 in the past and with whom he continued to have such dealings.  
22 He told this to Mrs. Myshraill as soon as the agents left.  
23 (R.T. 216-217.) Mr. Nielsen further testified that at this  
24 meeting he asked many questions about Mr. Goodman's personal  
25 and business affairs, and that he asked him to produce his  
26 personal cancelled checks. (R.T. 69,74.) He indicated





1 that they discussed Frigid Process Co. of South Pasadena  
2 and Las Vegas and that Mr. Goodman advised him that  
3 Mrs. Gedatus would have the records available for examination  
4 on December 30, 1964. (R.T. 73, 74.) Mr. Goodman and  
5 Mrs. Myshrall testified the meeting took only a few minutes.  
6 (R.T. 213, 307.) It is submitted that a meaningful  
7 explanation of constitutional rights alone could not have  
8 been given in such a short period of time. That  
9 Mrs. Myshrall and Mr. Goodman are probably telling the  
10 truth is further established by the document receipt  
11 given on this day. (Exhibit 3.) If there had been a  
12 meaningful explanation given and Mr. Goodman was told that  
13 he was the subject of a criminal investigation, there would  
14 have been no reason to issue the document receipt: "in re:  
15 James Pinkerton". Quite apparently, Mr. Goodman was not  
16 informed even though the records taken this day pertained  
17 solely to Paramount's deposit slips for the years 1961  
18 through 1964. The major portion of these records could  
19 not have had any application to Pinkerton's investigation  
20 or to Paramount's for years prior to 1962. These records,  
21 rather, only concerned Mr. Goodman and Paramount when it  
22 was owned by Mr. Goodman. The agents admitted that they  
23 knew Mr. Goodman was president of Paramount after April,  
24 1962. (R.T. 455.)

25 There is attached to this brief, as Appendix  
26 A, two letters to the University of Chicago Law Review



1 dated May 6, 1965 and May 27, 1965, from Mitchell Rogovin,  
2 then Chief Counsel of the Internal Revenue Service, who is  
3 presently Assistant Attorney General, Tax Division. These  
4 letters stated, in part, as follows:

5 "It is the general practice of the  
6 Intelligence Division that a taxpayer  
7 be advised in criminal income tax cases  
8 of his right to counsel when offered the  
9 opportunity to attend an interview with  
10 officials of that Division at the  
11 conclusion of the investigation."

12 (Emphasis supplied.)

13 Mr. Nielsen testified that he advised Mr. Goodman of his  
14 rights at the outset of the investigation notwithstanding  
15 the general policy of the Intelligence Division. It is  
16 submitted that an examination of Mr. Nielsen's conduct  
17 throughout this investigation demonstrates the improbability  
18 of such action on his part.

19 6. Mr. Nielsen testified that Mrs. Gedatus  
20 knew he and Mr. Loebig were coming to see her on December  
21 30, 1964. (R.T. 91.) This testimony is directly contra-  
22 dicted by Mrs. Gedatus. There is further conflict  
23 whether the agents told Mrs. Gedatus that they were  
24 conducting a "routine audit". (R.T. 248.) There has  
25 certainly been no reason demonstrated why Mrs. Gedatus  
26 would have purposefully lied about her meeting with the



1 agents.

2 7. The agents testified that the meeting  
3 conducted on January 8, 1965 was a pleasant meeting which  
4 began at about 11:00 A.M. and which was conducted in normal  
5 conversational tones. (R.T. 107.) The agents' character-  
6 ization of the meeting is in serious question since  
7 Mrs. Gedatus testified that she could hear the loud voices  
8 and shouting over the noise of the machinery, and that  
9 when Mr. Goodman left the meeting, he was so upset that  
10 she was worried about him and was required to place a  
11 telephone call for him. (R.T. 252-254.)

12 8. Mr. Nielsen testified that he and  
13 Mr. Loebig appeared at Frigid during the morning of  
14 January 12, 1965 and Mr. Nielsen specifically remembered  
15 seeing Mr. Goodman at 11:25 A.M. (R.T. 118.) Mr. Nielsen,  
16 however, does not remember when he and Mr. Loebig left  
17 Frigid that day; when they discussed taking the books  
18 and records with Mrs. Gedatus; or whether he returned to  
19 his office that day. (R.T. 119-120.) This was the day,  
20 however, when the original of Exhibit 6 was issued.  
21 Mr. Nielsen's testimony ultimately appears to be that he  
22 gave this receipt to Mrs. Gedatus and not to Mr. Goodman.  
23 (R.T. 120-121.) Mrs. Gedatus testified that this receipt  
24 was never given to her, but rather, that she was given a  
25 slip of paper which contained the various items taken by  
26 Mr. Nielsen. (R.T. 255-256.) In addition, she was also



1 given another slip of paper by Mr. Nielsen, (Exhibit 7),  
2 which contained Mr. Nielsen's telephone number. Mr. Nielsen  
3 stated that Exhibit 7 was genuine, and he further stated  
4 that he may have given Mrs. Gedatus a slip of paper listing  
5 the various records of Frigid which the agents took with  
6 them that day. (R.T. 122-123.) If the original of this  
7 exhibit had been given by Mr. Nielsen to Mrs. Gedatus,  
8 there would have been no reason why he would have had to  
9 give Mrs. Gedatus his telephone number on a separate slip  
10 of paper since Mr. Nielsen's telephone number is contained  
11 on the form. It appears to be appellees' contention that  
12 it was purely coincidental that on the very day Mr. Goodman  
13 was conferring with his then attorney for the first time,  
14 the agents decided to take Frigid's books with them to  
15 the Federal Building. According to Mr. Loebig, the reason  
16 the books were taken this day was that Mr. Nielsen wanted  
17 to examine Frigid's cancelled checks and "it would have  
18 taken a lot of time to go out to Frigid driving back and  
19 forth". (R.T. 464.) This is refuted by an examination  
20 of Exhibit 6 which reveals that not only were cancelled  
21 checks of Frigid taken, but in addition, the agents took  
22 all of Frigid's cash receipts, cash disbursements,  
23 purchases, sales and general journals on this date.

24 In instances where there has been a conflict  
25 between the testimony of a suspect and investigating agents,  
26 courts have noted the tendency on the part of the agents to





1 misrepresent the facts and have rejected such testimony.  
2 Greenwell v. United States, 336 F.2d 962 (D.C. Cir. 1964);  
3 Judd v. United States, 190 F.2d 649 (D.C. Cir. 1951).  
4 See also 8 Moore's Federal Practice, supra. Additionally,  
5 where a pattern of massive deception on the part of the  
6 investigating agents is shown to exist and conflicts  
7 between the agents' testimony and the testimony of third  
8 parties appear, a court should pause before accepting the  
9 agents' testimony. Further, where the agents' testimony  
10 conflicts with their own documents, i.e., the Document  
11 Receipts, the agents' story becomes doubtful.

12           While appellees could have attempted to  
13 corroborated the agents' testimony with the production of  
14 the contemporaneously prepared notes of the conference  
15 with Mr. Goodman, not only did they fail to do this, but  
16 they steadfastly refused to produce these in response to  
17 appellants' subpoenas duces tecum.

18           C. Appellees Have The Burden Of Proof To  
19 Establish That Appellants' Constitutional Rights Were  
20 Intelligently And Knowingly Waived.

21           The appellees have the burden of establishing  
22 by clear and convincing proof that the appellants waived  
23 their constitutional rights or consented to unconstitutional  
24 searches and seizures. This concept is consistent with the  
25 pronouncement found in Johnson v. Zerbst, 304 U.S. 458  
26 (1938), that "'courts indulge every reasonable presumption



1 against waiver' of fundamental constitutional rights".  
2 Miranda v. Arizona, 34 U.S.L.Week 4521 (U.S. June 13, 1966),  
3 makes it clear that this, more than ever is still the state  
4 of the law.

5 In two recent cases the Ninth Circuit  
6 has discussed the question of burden of proof when the  
7 issue of consent or waiver of constitutional rights has  
8 arisen. In Channel v. United States, 285 F.2d 217 (9th  
9 Cir. 1960), the court stated:

10 "A search and seizure may be made with-  
11 out a search warrant if the individual freely  
12 and intelligently gives his unequivocal and  
13 specific consent to the search, uncontaminated  
14 by any duress or coercion, actual or implied.  
15 The Government has the burden of proving by  
16 clear and positive evidence that such consent  
17 was given. Judd v. United States, 89 U.S.  
18 App. D.C. 64, 190 F.2d 649, 650."

19 In United States v. Page, 302 F.2d 81, 83-84  
20 (9th Cir. 1962), Judge Duniway stated:

21 "The government must prove that consent  
22 was given. It must show that there was no  
23 duress or coercion, express or implied. The  
24 consent must be 'unequivocal and specific'  
25 and 'freely and intelligently given'.  
26 There must be convincing evidence that the



1 defendant has waived his rights.

2 There must be clear and positive  
3 testimony. "'Courts indulge every  
4 reasonable presumption against waiver"  
5 of fundamental constitutional rights.'  
6 Coercion is implicit in situations where  
7 consent is obtained under color of the  
8 badge, and the government must show that  
9 there was no coercion in fact."

0 To the same effect see Villano v. United States, 310 F.2d  
1 680, 684 (10th Cir. 1962). In Carnley v. Cochran, 369  
2 U.S. 506, 516 (1962), the court stated that:

3 "The prosecution has the burden of  
4 showing that a suspect, once the investi-  
5 gation has reached the accusatory stage,  
6 was informed of his constitutional rights  
7 to counsel and to remain silent at that  
8 stage, or that he knowingly and intelli-  
9 gently waived those rights. Waiver cannot  
0 be presumed from a silent record."

1 In Greenwell, 336 F.2d at 966, in discussing  
2 the waiver of constitutional rights, the court stated:

3 "There is a presumption of involuntariness  
4 which the government must rebut, if it can,  
5 with 'clear and positive evidence'. Were  
6 the police version as to the accused's





1 cooperation always to be accepted,  
2 the laws' restriction on police  
3 activity would have little effect."

4 As stated above, Miranda reaffirmed these  
5 principles. The court there specifically reaffirmed the  
6 holding of Johnson, as applied to that factual situation,  
7 and cited Carnley, with approval.

8 D. Appellees Have Failed To Overcome Their  
9 Heavy Burden.

10 The only evidence in this entire record  
11 by which appellees attempt to overcome this "presumption  
12 of involuntariness", is the testimony of Mr. Nielsen  
13 and Mr. Loebig. (Mr. Stutz testified that his testimony  
14 was based primarily upon a reading of Mr. Nielsen's  
15 memoranda.) Appellees apparently chose not to bolster  
16 such testimony by producing any written notes or memoranda.

17 It is submitted that sufficient areas of  
18 doubt have been established throughout this entire record  
19 which rule out any conclusion that appellees have proved  
20 waiver by clear, convincing and positive testimony.  
21 Significantly, both Mr. Nielsen and Mr. Loebig testified  
22 that they did not know whether Mr. Goodman understood the  
23 criminal nature of the investigation that they were  
24 conducting of appellants. (R.T. 102, 103.) Mr. Loebig  
25 specifically said he did not know what was in Mr. Goodman's  
26 mind in this respect. (R.T. 443.) The above cases clearly



1 establish that the existence of any doubts of waiver or  
2 consent must be resolved against appellees.

3 It is submitted that when the pattern of  
4 significant testimonial inconsistency is studied, it not  
5 only demonstrates the questionableness of agents' credibility,  
6 but demonstrates that the findings of fact and conclusions  
7 of law are clearly erroneous and should be set aside.  
8 Considering the heavy burden which rests upon the  
9 appellees, it is submitted that the agents' testimony  
0 should have been rejected by the District Court.

1 IV.

2 ALL BOOKS AND RECORDS OBTAINED FROM APPELLANTS MUST BE  
3 SUPPRESSED AS EVIDENCE AND COPIES THEREOF RETURNED TO  
4 APPELLANTS

5 A. Constitutional Rights Attach At The Commence-  
6 ment Of A Criminal Tax Investigation.

7 As early as 1835, the Supreme Court in Boyd v.  
8 United States, 116 U.S. 616 (1885), established that  
9 constitutional rights attach to private books and records.  
0 The question presented in this case concerns the particular  
1 point in time when these constitutional rights attach  
2 during the course of an Internal Revenue Service investi-  
3 gation. In the most recent case of Miranda v. Arizona,  
4 34 U.S.L. Week 4521 (U.S. June 13, 1966), the Supreme Court  
5 held that a person's constitutional rights attach at the  
6 time he "has been taken into custody or otherwise deprived



of his freedom of action in any significant way." Since Miranda did not purport to decide the question of when these constitutional rights attach in non-custody situations or where custody rarely, if ever occurs, this Court must determine the effect of Miranda in non-custody situations and formulate guidelines in this area.

1. The function of a Special Agent in an Internal Revenue Service investigation is to conduct a criminal investigation.

An Internal Revenue Service investigation is the non-custody situation involved in this case. There are two basic types of agents of the Internal Revenue Service: special agents of the Intelligence Division and revenue agents of the Audit Division. The function of special agents is to enforce

"The criminal statutes applicable to income, estate, gift, employment and excise tax laws. . .by developing information concerning alleged criminal violations thereof, evaluating allegations and indications of such violations to determine investigations to be undertaken, investigating suspected criminal violations of such laws, recommending prosecution when warranted, and measuring effectiveness



1 of the investigation and prosecution  
2 processes." (Emphasis supplied.)

3 30 Fed. Reg. 9399-9400 (July 28, 1965),  
4 1966 CCH Stand. Fed. Tax Rep. §5988.

5 The basic function of revenue agents, on  
6 the other hand, is to conduct field examinations to deter-  
7 mine the correct civil liabilities of taxpayers, and,  
8 occasionally to "participate with special agents of the  
9 Intelligence Division in the conduct of tax fraud investi-  
10 gations. . . ." 30 Fed. Reg. 9399 et seq. (July 28, 1965),  
11 1966 CCH Stand. Fed. Tax Rep. §5988. During the course of  
12 an investigation conducted by a special agent, the sole  
13 purpose is to obtain evidence of the commission of a crime.  
14 At no time is the special agent or, in a joint investi-  
15 gation, the revenue agent, to discuss or attempt to settle  
16 the question of civil tax liability. As one commentator  
17 aptly noted:

18 "The sole function of a special  
19 agent in the Intelligence Division of  
20 the Internal Revenue Service is to  
21 seek evidence of crimes. He has no  
22 concern whatsoever with the amount  
23 or collection of any additional tax,  
24 these being strictly the concern of  
25 the revenue agent. He is exactly  
26 the same as any other Treasury Agent





who may seek evidence of narcotics, counterfeiting, alcohol tax, customs violations, etc. A special agent is a criminal law enforcement officer, just like any state or municipal detective or policeman." Burns, Searches and Seizures: The Suppression of Evidence, 20 N.Y.U. Institute on Federal Taxation 1081, 1087 (1962).

If, at the conclusion of the criminal investigation, the special agent recommends criminal prosecution, the taxpayer is then afforded the opportunity to confer at various levels with government officials in both the Treasury and Justice Departments. If the taxpayer fails at all of these various conference levels to dissuade prosecution, the case is then referred to the United States Attorney who is instructed to obtain an indictment. Very rarely, if ever, will an arrest occur prior to indictment in an Internal Revenue Service investigation.

The taxpayer's right to refuse access to his books and records in a criminal tax investigation is as important to him as is the suspect's right to remain silent in the normal criminal investigation. In each case the investigator is attempting to elicit either incriminating statements or incriminating books and records; each



in its own way provides the basis for a successful prosecution from either his lips or his pen.

With this brief background, an analysis of the Supreme Court's decision in Miranda becomes necessary to determine at what point the constitutional privileges so carefully preserved in Miranda attach for the protection of the taxpayer under criminal investigation.

2. Miranda does not purport to determine when constitutional rights attach in non-custody situations.

Miranda begins where Escobedo v. Illinois, 378 U.S. 478 (1964) terminates. In Escobedo, the Supreme Court stated that the police investigation of an accused prior to trial was a most significant stage when constitutional rights may be irretrievably lost. The court stated:

"This was the 'stage when legal aid and advice' were most critical to petitioner. . . .since rights 'may be as irretrievably lost, if not then and there asserted, as they are when an accused represented by counsel waives a right for strategic purposes.'"

Id. at 486.

In expanding upon the need for protection of constitutional rights prior to trial, the court stated:

"The rule sought by the State here,



1 however, would make the trial no more  
2 than appeal from the interrogation;  
3 and the 'right to use counsel at the  
4 formal trial [would be] a very hollow  
5 thing [if], for all practical purposes,  
6 the conviction is already assured by  
7 pre-trial examination'. . . . 'One can  
8 imagine a cynical prosecutor saying:  
9 "'Let them have the most illustrious  
10 counsel, now. They can't escape the  
11 noose. There is nothing that counsel  
12 can do for them at the trial.'" Id.  
13 at 487-88.

14 In Miranda and its three companion  
15 cases (Vignera v. New York, Mossbauer v. United States and  
16 California v. Stewart), all four of the defendants were in  
17 police custody at the time they uttered the incriminating  
18 statements. The court elaborated upon the need for  
19 protecting constitutional privileges when a criminal  
20 defendant is in the custody of the police and noted that

21 "There can be no doubt that the Fifth  
22 Amendment privilege is available outside  
23 of criminal court proceedings. . . ."  
24 34 U.S.L. Week at 4530,

25 and that

26 "The prosecution may not use statements,





whether exculpatory or inculpatory, stemming from custodial interrogation of the defendant unless it demonstrates the use of procedural safeguards effective to secure the privilege against self-incrimination. By custodial interrogation, we mean questioning initiated by law enforcement officers after a person has been taken into custody or otherwise deprived of his freedom of action in any significant way."

Id. at 4523.

The court in Miranda did not purport to examine the question of when these constitutional rights attach if the particular crime involved did not involve "custody" or the "deprivation of freedom of action in any significant way". Nonetheless, the combined philosophy of Escobedo and Miranda must be considered applicable where the particular crime involved does not normally result in "custody".

3. This Court must determine when constitutional rights attach in an Internal Revenue Service investigation.

In applying Miranda, it is clear that the rights granted by the Fifth and Sixth Amendments to the Constitution must attach at some point prior to the conclusion of the investigation. If this were not the case,



1 the presence of counsel at trial would have little effect  
2 and would be a meaningless and empty gesture. Logically,  
3 Miranda and Escobedo must apply to violations of income  
4 tax laws just as it does with respect to violations of  
5 other criminal statutes. This was most aptly phrased by  
6 one court:

7 "In these days of Constitutional  
8 turmoil concerning the rights and  
9 privileges of an accused person as  
0 guaranteed by the United States  
1 Constitution, it should be obvious  
2 that a taxpayer charged with violating  
3 the Internal Revenue Code is entitled  
4 to the same Constitutional protection  
5 as a person charged with committing  
6 a crime of violence. In that regard  
7 also, when agents of the Internal  
8 Revenue Service seek out evidence of  
9 a violation of the tax laws with a  
0 view toward a criminal prosecution,  
1 they occupy the same position as a  
2 policeman or detective who is ferreting  
3 out crimes on a wider scale and usually,  
4 of a different nature." United States v.  
5 Gower, \_\_\_\_\_ F.Supp.\_\_\_\_\_, 65-2 USTC  
6 ¶15,655 (M.D.Pa. 1965).



1 When do the rights guaranteed by the  
2 Fifth and Sixth Amendments attach in a tax investigation?

3 When a revenue agent is conducting an  
4 audit of a particular taxpayer's books, his inquiry is  
5 entirely of a civil nature and no warning of constitutional  
6 rights need be given by him. But when a criminal  
7 investigator such as a special agent initiates an investi-  
8 gation, an effective warning of these rights must be given.  
9 Appellants contend that a full scale criminal investigation  
0 of Mr. Goodman by a special agent began on December 18,  
1 1964. At this point, Mr. Goodman should then have been  
2 meaningfully advised of his constitutional rights.

3 4. Appellants should have been advised of  
4 their constitutional rights at the commencement of this  
5 criminal investigation.

6 In the instant case, the investigation  
7 of appellants originally commenced as an investigation of  
8 James Pinkerton. (R.T. 9, 17.) That investigation was  
9 commenced by two special agents of the Internal Revenue  
0 Service, both attached to the Intelligence Division.  
1 (R.T. 18.) That investigation occurred primarily during  
2 the month of April, 1964, and took place at the offices  
3 of Paramount. (R.T. 18.)

4 Approximately six months later,  
5 Mr. Nielsen discussed Mr. Goodman with his group supervisor  
6 and obtained approval to requisition Mr. Goodman's personal



1 income tax returns. (R.T. 56; Exhibit 9.) Mr. Nielsen  
2 requisitioned these returns during November as a part of an  
3 "official investigation". (R.T. 58, 61.) Although  
4 Mr. Nielsen testified that the purpose for requisitioning  
5 these returns was to determine whether Mr. Goodman reported  
6 a particular item of income, Mr. Nielsen maintained  
7 possession of these returns even though he was satisfied  
8 that the particular item of income had, in fact, been  
9 reported. (R.T. 61-2, 446.) On December 18, 1964,  
0 Mr. Nielsen returned to Paramount, this time accompanied  
1 by Internal Revenue Agent Keith Loebig. Mr. Nielsen  
2 admitted that he knew Mr. Goodman had acquired control of  
3 Paramount as of March, 1962, (R.T. 455), yet he examined  
4 Paramount's books for the period subsequent to March,  
5 1962; something which he had never previously done.  
6 (R.T. 44-45; Exhibit 2.) Mr. Goodman's returns were in  
7 his possession when he visited Paramount on this date.  
8 (R.T. 446.) Mr. Nielsen admitted that on December 18, 1964  
9 no warning whatsoever was given relating to any  
0 constitutional rights. (R.T. 62.)

1 On their return to Paramount on December  
2 21, 1964, Mr. Nielsen claimed he informed Mr. Goodman  
3 that he was now the subject of an investigation and he  
4 was asked to identify his personal returns and asked to  
5 produce his personal cancelled checks. (R.T. 67-69, 76.)  
6 On this date, the books and records of Paramount for the





1 period subsequent to March of 1962 were further examined.  
2 (Exhibit 3.) This investigation of Mr. Goodman by means  
3 of an examination of the books and records of Paramount  
4 continued during the balance of December. On December 30,  
5 1964, the agents asked to see the books and records of  
6 Frigid, (R.T. 90-91.), a corporation wholly owned by  
7 Mr. Goodman, as a continuing part of the investigation of  
8 him. During January, 1965, the agents carefully examined  
9 and analyzed substantially all of the books and records of  
10 Frigid.

1 It is submitted that all of the foregoing  
2 demonstrates that this criminal investigation of Mr. Goodman  
3 conducted by a special agent began not later than  
4 December 18, 1964 and that he should have been admonished  
5 of his constitutional rights also not later than that time.

6 If the criminal investigation of  
7 Mr. Goodman did not commence by December 18, 1964, there  
8 can be little question but that it began by December 21,  
9 1964. Mr. Nielsen testified as follows:

10 "I told Mr. Goodman that up to  
11 this time all of our discussions with  
12 him, all of our conversations out there  
13 had been pertaining to the Pinkerton-  
14 Paramount investigation. I said at  
15 this time, at December 21, 1964, we  
16 were speaking to him regarding his



own personal income tax returns. I said that I now had an investigation on his own personal returns." (R.T. 67-68.)

Clearly, from this time forward, the agents were conducting a full scale investigation of Mr. Goodman and were attempting to obtain either incriminating statements or incriminating books and records in order to establish his commission of a criminal violation of the Internal Revenue laws. Our basic concepts of fairness for accuseds demand that an admonition of constitutional rights should be given at this point.

B. The Required Admonition Of Constitutional Rights Was Not Given.

1. Miranda requires that warning of constitutional rights must be meaningful.

In Miranda, the Supreme Court held that:

"Prior to any questioning, the person must be warned that he has a right to remain silent, that any statement he does make may be used as evidence against him, and that he has a right to the presence of an attorney, either retained or appointed. The defendant may waive effectuation of these rights, provided the waiver is made voluntarily knowingly



1 and intelligently." 34 U.S.L. Week at 4523.

2 Since the factual situations in Miranda and its three  
3 related cases all involve instances where the subject was  
4 in police custody, it was apparent that the subjects were  
5 obviously aware of the fact that they were the subjects  
6 of a criminal investigation. However, where one is unaware  
7 of the fact that a criminal investigation is in process  
8 or that he is the subject of that criminal investigation,  
9 the Supreme Court in Miranda certainly would have insisted  
10 that the investigator inform the subject of these facts  
11 so that the ensuing warning of Fifth and Sixth Amendment  
12 rights would be meaningful.

13 2. Appellants were not effectively advised  
14 of their constitutional rights since they were not  
15 informed of the criminal nature of the investigation.

16 Mr. Nielsen admitted that on December 18,  
17 1964, no admonitions of any constitutional rights were  
18 given. (R.T. 62.) On December 21, 1964, Mr. Goodman  
19 was not advised that the investigation then in progress  
20 was a criminal investigation. (R.T. 67-68.) Since  
21 Mr. Goodman was not in custody, it was incumbent for the  
22 special agent to inform him that the investigation was one  
23 of a purely criminal nature. Mr. Nielsen testified that  
24 he never used the word "criminal" or "penitentiary" at  
25 any time during this entire investigation. (R.T. 68.)  
26 Mr. Loebig recalled that the only time the word "criminal"





1 was used was on January 8, 1965, toward the end of the  
2 entire investigation. (R.T. 450, 454.) Mr. Loebig  
3 further testified that he had no idea whether Mr. Goodman  
4 realized, prior to January 8, 1965, that a criminal  
5 investigation was in progress. (R.T. 443.)

6 Since this investigation originally  
7 commenced as an investigation of Mr. Pinkerton which  
8 subsequently shifted to an investigation of appellants,  
9 the attendant confusion demonstrated above rendered it  
10 especially important that a clear and meaningful  
11 explanation of the criminal nature of the investigation  
12 be given appellants.

13 If it held that if a meaningful admoni-  
14 tion of constitutional rights should have been given on  
15 December 18, 1964, the statements made to Mr. Goodman on  
16 December 21, 1964 (R.T. 67-68) should not be considered  
17 as curing the defects which arose on December 18, 1964.  
18 Once Mr. Goodman had unwittingly allowed the agents to  
19 review and examine Paramount's post-1962 books and records  
20 on December 18, 1964, it was futile for him to have later  
21 refused to deliver additional books and records. If an  
22 admonition of constitutional rights is to be meaningful  
23 choice between two alternatives, such a warning must  
24 occur prior to the improper delivery of any incriminating  
25 documents.

26 Although the agents testified that at his



1 request, Mr. Goodman was apprised of the difference between  
2 a special agent and a revenue agent in April, 1964 during  
3 the investigation of James Pinkerton, it cannot be  
4 seriously contended that this explanation was adequate.  
5 The length of time which elapsed, a period of eight and  
6 one-half months, nullified the consequence of such a  
7 prior explanation if it in fact was actually given. Surely  
8 one must be informed of the criminal nature of an investi-  
9 gation at a time in reasonably close proximity to the actual  
0 warning of any constitutional rights. Additionally, there  
1 is substantial question whether Mr. Neilsen's explanation  
2 of the different functions of a special agent and a revenue  
3 agent in April, 1964 was adequate to convey, in a meaning-  
4 ful fashion, this distinction to a lay person. In relating  
5 this explanation, Mr. Neilsen testified:

6 "I told him an Internal Revenue  
7 Agent conducts civil audits; a Special  
8 Agent conducts an investigation to  
9 determine whether any of the Internal  
0 Revenue laws have been violated, whether  
1 there has been any attempt to evade or  
2 defeat the payment of any income taxes."

3 (R.T. 24)

4 The confusing nature of this explanation  
5 is apparent when it is recognized that there are many  
6 sections of the Internal Revenue Code which use



1 substantially similar or identical language in discussing  
2 civil, as opposed to criminal, conduct. Compare civil section  
3 6653(a), 6653(b), 6653(e), 6672, 6674, and 7205, of the  
4 Internal Revenue Code of 1954, as amended, with criminal  
5 sections 7201, et seq. of the Internal Revenue Code of 1954,  
6 as amended.

7 3. Kohatsu v. United States is distinguishable

8 Kohatsu v. United States, \_\_\_\_ F.2d \_\_\_\_  
9 (9th Cir. 1965) cert. den. \_\_\_\_ U.S. \_\_\_\_ (1966), is  
0 inapplicable to this case. In Kohatsu, the taxpayer was  
1 always aware that he was the subject of an Internal Revenue  
2 investigation. In this case, however, Mr. Goodman did  
3 not know (and had no way of knowing) that he was the subject  
4 of any type of investigation when the agents returned to  
5 Paramount on December 18, 1964. But the most significant  
6 distinction between this case and Kohatsu is the fact that  
7 the investigation in Kohatsu originally commenced as a civil  
8 investigation and shifted to one which was criminal in  
9 nature. In this case, the investigation was always  
0 criminal in nature. Thus, the burden this Court thought  
1 inappropriate to impose upon the government in Kohatsu,  
2 i.e., advising a taxpayer as to the direction in which the  
3 necessarily fluctuating investigation leads, is simply not  
4 involved in this case.

5 C. The Obtaining Of Books And Records Commencing  
6 On December 18, 1964, Violated The Fourth Amendment.



1 Even if it were conceded, which it is not, that  
2 the agents fully apprised Mr. Goodman of his constitutional  
3 rights and the fact that he was the suspect in a criminal  
4 investigation, it is submitted that the obtaining of  
5 Paramount's books and records and Mr. Goodman's records  
6 on and after December 18, 1964, violated Paramount's and  
7 Mr. Goodman's rights under the Fourth Amendment.

8 In Channel v. United States, 285 F.2d 217  
9 (9th Cir. 1960), this court, prior to Escobedo and  
10 Miranda held that if an individual's consent to a search  
11 amounts to nothing more than false bravado, the consent  
12 is not truly voluntarily given. See also Judd v. United  
13 States, 190 F.2d 649 (D.C. Cir. 1951).

14 According to Mr. Nielsen's testimony, on  
15 December 21, 1964, Mr. Goodman after being advised of  
16 his rights, stated: "I understand my rights. I have  
17 nothing to hide. Go ahead and question me." (R.T. 69.)  
18 This alleged statement bears striking similarity to those  
19 uttered by the defendants in Channel and Judd. It is  
20 submitted that Mr. Goodman, having been previously  
21 questioned at various times prior to December 21, 1964  
22 by different government agents to whom a considerable  
23 quantity of books and records had previously been supplied,  
24 who was confused at the nature and scope of the investi-  
25 gation, who had not consulted counsel, did not freely and  
26 intelligently give his unequivocal and specific consent to





1 an examination of any of the books and records of appellants

2 In light of Misconduct and Winters, the teachings  
3 of Channel and Judd are more viable today than when they  
4 were first enunciated. When all of the factors in this  
5 case are considered, it is submitted that, on and after  
6 December 18, 1964, Mr. Goodman did not voluntarily and  
7 intelligently consent to the examination of any of the  
8 books and records. Therefore, all of such records were  
9 obtained illegally and must be suppressed as evidence and  
10 all copies thereof returned to appellants.

1 It is submitted that a criminal investigation  
2 in this case was commenced by December 18, 1964, or in  
3 no event later than December 21, 1964. As a prerequisite  
4 to the use of any evidence obtained from such investi-  
5 gation, the agents were required to explain to Mr. Goodman,  
6 in a meaningful fashion, that he was the subject of a  
7 criminal investigation and admonish him of his  
8 constitutional rights under the Fifth and Sixth Amendments.  
9 Since these warnings and statements were either not made,  
10 or not effectively and meaningfully made, all evidence  
11 obtained on and after the relevant date must be suppressed  
12 and all copies of books and records must be returned to  
13 appellants. Any additional information or evidence which  
14 was derived, directly or indirectly, from said illegally  
15 obtained evidence must be suppressed as well. As  
16 Mr. Justice Holmes said in Silverthorne Lumber Co. v.



1 United States, 251 U.S. 385, 392 (1920), "the essence  
2 of a provision forbidding the acquisition of evidence in  
3 a certain way is that not merely evidence so acquired shall  
4 not be used before the court but that it shall not be used  
5 at all." See also Nardone v. United States, 302 U.S.  
6 379 (1937).

7 CONCLUSION

8 Appellants respectfully submit that the  
9 District Court erred in granting appellees motion to quash  
0 appellants' subpoenas duces tecum and that this case should  
1 be remanded to the District Court with instructions that  
2 the subpoenas be honored and further proceedings be held.

3 Appellants further submit that the Judg-  
4 ment of the District Court is erroneous and should be re-  
5 versed and that this Court determine that all of appellants'  
6 books, records and memoranda were obtained in violation of  
7 the Fourth, Fifth and Sixth Amendments to the Constitution  
8 of the United States, that all such material be suppressed  
9 as evidence in any future proceedings, and that all such  
0 material and all copies thereof be returned to appellants.

1 Respectfully submitted,

2 GOODSON AND ASSOCIATES

3 By


4 Walter S. Weiss

5 Walter S. Weiss

6 Counsel for Appellants



1 I certify that, in connection with the  
2 preparation of this brief, I have examined Rules 18 and 19  
3 of the United States Court of Appeals for the Ninth Circuit  
4 and that, in my opinion, the foregoing brief is in full  
5 compliance with those rules.  
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Walter S. Weiss







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APPENDIX A  
U.S. TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

MAY 6 1965

Mr. Duane W. Krohnke  
Office of the Editor  
The University of Chicago Law Review  
Chicago 37, Illinois

In re: Application of Massiah  
and Escobedo to Income  
Tax Investigations

Dear Mr. Krohnke:

This is in further regard to your letters of March 29, 1965 to Mr. G. d'Andelot Belin, General Counsel of the Treasury Department, and Mr. Arnold Sagalyn, Director, Office of Law Enforcement Coordination, regarding the Massiah and Escobedo cases. Specifically, you inquire as to their effect on the investigative techniques of law enforcement agencies of the Treasury Department. Our remarks are limited to the manner in which the cases in question affect the investigative activities of the Internal Revenue Service in the income tax area.

In Massiah v. United States, 377 U.S. 201 (1964), incriminating statements made by the petitioner and picked up on a hidden radio were deemed inadmissible as evidence. The Court relied on the Sixth Amendment guarantee of right to counsel and did not reach the question of petitioner's Fourth Amendment rights.

Petitioner was free on bail after being indicted for violation of the narcotics law. The incriminating statements were made in the



automobile of a confederate who, unknown to the petitioner, had agreed to let narcotics agents install a radio transmitter in the vehicle. The statements were overheard by an agent and were admitted in evidence over the objections of petitioner. The court of appeals affirmed the conviction.

The Supreme Court reversed, and in so doing stressed its decision of Spano v. New York, 360 U.S. 315 (1959), wherein a state court conviction was overturned because of the admission of a confession obtained after the defendant's indictment. Four concurring Justices had pointed out in Spano that "the Constitution required reversal of the conviction upon the sole and specific ground that the confession had been deliberately elicited by the police after the defendant had been indicted, and therefore at a time when he was clearly entitled to a lawyer's help." In the present case, the Court felt that the use of the incriminating statements denied petitioner the basic protection of the Sixth Amendment "when there was used against him at his trial evidence of his own incriminating words, which federal agents had deliberately elicited from him after he had been indicted and in the absence of his counsel." The Court stressed the fact that it was not ruling on the propriety of continuing surveillance of petitioner while he was free on bail, but only that his own incriminating statements, obtained under these circumstances, could not be used against him.

In Escobedo v. Illinois, 378 U.S. 478 (1964), the failure to honor Escobedo's request to consult



with his lawyer during the course of an investigation was held to be a denial of the assistance of counsel guaranteed by the Sixth and Fourteenth Amendments.

When Escobedo was interrogated by the police about the murder of his brother-in-law the police refused both his repeated requests to confer with his attorney and his attorney's attempts to see him. He admitted implication in the murder, was convicted, and the Illinois Supreme Court affirmed the admission of his statement.

The Supreme Court reversed and remanded, holding that it made no difference that the interrogation was conducted before Escobedo was formally indicted. It was the Court's view that when Escobedo requested, and was denied, an opportunity to consult with his lawyer, the investigation had ceased to be a general investigation of "an unsolved crime." The Court pointed out that the police had not informed him of his absolute right to remain silent, and declared that the "guiding hand of counsel" was essential to advise him of his rights.

In sum, the Court held that when the process of criminal law enforcement shifts from investigatory to accusatory, when its focus is on the accused and its purpose is to elicit a confession, our adversary system begins to operate and the accused must be permitted to consult his lawyer.

As a predicate for discussing whether or not these cases have any applicability to the



income tax area, an outline of the general investigative procedures of the Internal Revenue Service is in order.

The first contact with a taxpayer is often made by an Internal Revenue Agent whose duties involve the auditing of returns to determine the correct tax liability. If he finds indications of fraud, he refers the matter to his superiors who, if the facts justify such action, contact the Intelligence Division. A special agent may be assigned to look into the matter. He may informally interview the taxpayer (on a voluntary basis), contact third parties, and examine records. There may be other contacts with the taxpayer. The taxpayer is always free to consult or call in his attorney.

If the subsequent investigation develops evidence to warrant an Intelligence Division finding that a crime was probably committed and that the taxpayer probably committed it, the taxpayer is usually afforded the opportunity to appear with his attorney at a formal conference. Having completed his investigation, a special agent submits a report wherein he analyzes available data and makes a recommendation. If he has recommended prosecution and the Assistant Regional Commissioner (Intelligence) agrees, the matter is forwarded to one of our Regional Counsel.

At this point the case is accorded its first plenary legal review to determine if the evidence is sufficient to establish guilt beyond





a reasonable doubt and whether there is a reasonable probability of conviction. The taxpayer is usually offered a conference, whereat he is apprised of his rights under the Fifth and Sixth Amendments, advised of the Intelligence Division recommendation and the general procedure for reviewing criminal tax cases, and afforded the opportunity to make a statement.

If Regional Counsel concludes that the case should be prosecuted, he makes an appropriate recommendation and forwards it to the Department of Justice. Thereafter, until final disposition of the criminal case, the Internal Revenue Service generally takes no further investigatory action except with the approval of the Department of Justice.

For further information as to the aforestated investigative and review procedures see Kostelanetz and Bender, Criminal Aspects of Tax Fraud Cases (August 1957); Balter, Tax Fraud and Evasion (3rd Ed., 1963); Schmidt, Legal and Accounting Handbook of Federal Tax Fraud (1963).

With this background, it becomes clear that Massiah and Escobedo have no across-the-board applicability in the area of criminal income tax investigations.

In view of the fact that the incriminating statements in Massiah were secured after indictment, that decision should have virtually no effect on the investigative techniques of our agents in the income tax area. In contrast to



the factual setting of Massiah, it is extremely unlikely that a special agent in an income tax investigation will be confronted with a situation where one member of a criminal conspiracy has been indicted and thereafter he must perform further investigation to develop evidence relative to unknown individuals.

In regard to Escobedo, we note that the Court, in determining that Escobedo's Constitutional rights were violated, commented:

"The interrogation here was conducted before petitioner was formally indicted. But in the context of this case, that fact should make no difference. \* \* \* It would exalt form over substance to make the right to counsel, under these circumstances, depend on whether at the time of the interrogation, the authorities had secured a formal indictment. Petitioner had, for all practical purposes, already been charged with murder." (Emphasis added.) (pp. 485, 486.)

In reversing the conviction, the Court stated:

"We hold, therefore, that where, as here, the investigation is no longer a general inquiry into an unsolved crime but has begun to focus on a particular suspect, the suspect has been taken into police custody, the police carry out a process of interrogation that lends itself to eliciting incriminating statements, the suspect has requested and been denied an opportunity to consult with his lawyer, and the



police have not effectively warned him of his absolute constitutional right to remain silent, the accused has been denied 'the Assistance of Counsel' in violation of the Sixth Amendment to the Constitution. \* \* \*." (Pp. 490-491.)

The Supreme Court thus predicated its decision upon the presence of certain specific circumstances. Our reaction to these factors is that: (1) the circumstance of a known crime needing only the perpetrator's identity is simply not present in tax investigations; (2) the accusatory stage is reached in a criminal tax case only at the moment of arrest or upon the return of an indictment or filing of an information; (3) a taxpayer during the course of an inquiry into his tax affairs is not, barring an arrest, physically within the power of the special agent, nor is he, even if interrogated under the authority of a summons, inevitably under coercive pressure unless he knows of his right to remain silent or to have the assistance of counsel; and (4) a request to consult with an attorney is never denied by the Internal Revenue Service--to the contrary, and although there is no requirement to do so, a taxpayer is specifically advised at various stages during the processing of a criminal tax case of such right.

Undoubtedly the Escobedo and Massiah decisions may cause some disagreement both as to their precise scope and their effect on present criminal investigatory procedures. See 78 Harv. L. Rev.





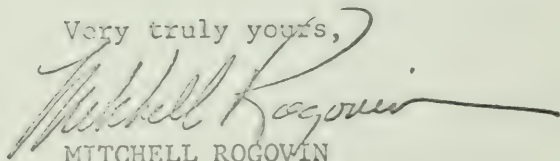
217 (1964); 26 U. Pitt. L. Rev. 151 (October 1964); 33 U. Cin. L. Rev. 523 (Fall 1964); 14 DePaul L. Rev. 187 (Autumn-Winter 1964); 3 Duquesne U. L. Rev. 102 (Fall 1964); 48 Marq. L. Rev. 247 (Fall 1964); 38 So. Calif. L. Rev. 156 (1965); 9 St. Louis U. L. J. 281 (Winter 1964).

In sum, and in view of the investigative procedures described herein, we do not believe that the decisions are applicable in the income tax area. Accordingly, our procedures have not been changed nor do we expect to encounter any administrative difficulty in applying the rationale of said cases.

Inasmuch as the manuals used by the Internal Revenue Service are for intra-agency use only and are not available for public perusal we regret that we are unable to furnish specific citations thereto. However, we have referenced for your consideration several books wherein is discussed the role of a special agent in criminal tax investigations.

It is hoped that the foregoing will be of assistance.

Very truly yours,



MITCHELL ROGOVIN

Chief Counsel

*We would be interested in receiving a copy of your Law Review comments*



U.S. TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE

WASHINGTON, D.C. 20224

MAY 27 1965

Mr. Duane W. Krohnke  
Office of the Editor  
The University of Chicago Law Review  
Chicago 37, Illinois

In re: Application of Massiah  
and Escobedo to Income  
Tax Investigations

Dear Mr. Krohnke:

This replies to your May 10 request for elaboration on our statement that "although there is no requirement to do so, a taxpayer is specifically advised at various stages during the processing of a criminal (income) tax case of such right to counsel)."

Numerous cases support the proposition that there is no duty resting upon an investigating special agent to warn a taxpayer that he does not have to testify against himself or to give any information that might be used against him, and the relevant inquiry is limited to whether the information has been understandingly and willingly given. United States v. Frank, 245 F.2d 284 (3rd Cir. 1957) cert. den. 355 U.S. 819; Hanson v. United States, 186 F.2d 61 (8th Cir. 1950); Turner v. United States, 222 F.2d 926 (4th Cir. 1955) cert. den. 350 U.S. 831; Scanlon v. United States, 223 F.2d 382 (1st Cir. 1955); Lloyd v. United States, 226 F.2d 9 (5th Cir. 1955); United States v. Selafani, 265 F.2d 408 (2nd Cir. 1959) cert. den. 360 U.S. 918.



The latest decision so holding is United States v. Spomar, 339 F.2d 941 (7th Cir. 1964), cert. den. \_\_\_\_ U.S. \_\_\_\_ (1965). This case is of particular importance in that the court rejected the defendant's argument that information, even though voluntarily given, could not be introduced into evidence against him because he had no knowledge of his constitutional right to refuse to furnish such information. Defendant contended that the mere lack of knowledge of his constitutional rights was enough to vitiate the voluntary surrender of his records. In denying such assertion the court indicated that to hold otherwise would bind the Government by defendant's subjective state of mind which is not subject to proof, and would stand for the untenable proposition that one who has no duty to advise a taxpayer of his constitutional rights may nevertheless be held responsible for taxpayer's ignorance of such rights. This case was decided six months after the Escobedo decision. The Seventh Circuit apparently did not consider that the factual setting before it fell within the purview of Escobedo.

The Spomar holding is that Escobedo does not require a special agent to voluntarily advise a taxpayer of his Fifth Amendment right against self-incrimination. The Spomar rationale would similarly support the proposition that, despite the Supreme Court's holding in Escobedo that a Sixth Amendment "right to counsel" exists under certain circumstances during an investigation, an agent is under no duty to voluntarily advise a taxpayer of it.

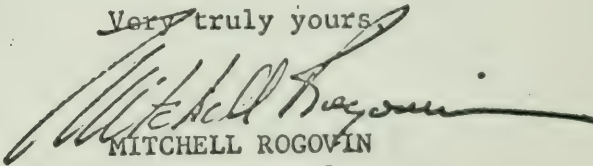


Irrespective of this interpretation of Spomar, it is the general practice of the Intelligence Division that a taxpayer be advised in criminal income tax cases of his right to counsel when offered the opportunity to attend an interview with officials of that Division at the conclusion of the investigation. Similarly, he is orally advised of such right when meeting with representatives of Regional Counsel's office. This practice is, of course, predicated solely upon a recognition of the administrative desirability to apprise an individual of his right to counsel as contrasted with any legal requirement to do so. Obviously, under certain circumstances (e.g., where the taxpayer is known to have retained counsel or is himself an attorney) explicit advice of right to counsel may be inappropriate.

Regarding your proposed Law Review comment, we have no objection to your quoting from, or referring to, correspondence received from this office.

It is hoped that the foregoing will be of assistance.

Very truly yours,



MITCHELL ROGOVIN  
Chief Counsel





EXHIBITS IN EVIDENCE

Exhibit Number

Pages of Reporter's Transcript (W.T.)

Identified

Offered

Received

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**JACK GOODMAN, PARAMOUNT ICE CREAM CORP.  
AND FRIGID PROCESS CO., APPELLANTS**

*v.*

**UNITED STATES OF AMERICA, ET AL., APPELLEES**

---

**On Appeal from the Order of the United States District  
Court for the Southern District of California**

---

**BRIEF FOR THE APPELLEES**

---

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**FILED**

**AUG 22 1966**

**WMA B LICK, CLERK**



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**In the United States Court of Appeals  
for the Ninth Circuit**

---

No. 20,811

**JACK GOODMAN, PARAMOUNT ICE CREAM CORP.  
AND FRIGID PROCESS CO., APPELLANTS**

*v.*

**UNITED STATES OF AMERICA, ET AL., APPELLEES**

---

**On Appeal from the Order of the United States District  
Court for the Southern District of California**

---

**BRIEF FOR THE APPELLEES**

---

**JURISDICTION**

As hereinafter more fully brought out, the order denying appellants' motion to suppress in this case is not appealable, and, consequently, this Court is without jurisdiction.

**QUESTIONS PRESENTED**

1. Whether an order denying a motion to suppress evidence is appealable.

2. Whether appellants' constitutional rights were violated when they voluntarily gave corporate and personal records to agents of the Internal Revenue Service.

3. Whether the District Court erred in failing to enforce appellants' subpoenas requiring the production of internal reports, memoranda, and manuals of the Internal Revenue Service.

### STATUTE AND RULE INVOLVED

28 U.S.C.:

Sec. 1291 [as amended by Sec. 48, Act of October 31, 1951, c. 655, 65 Stat. 710, and Sec. 12(e), Act of July 7, 1958, P.L. 85-508, 72 Stat. 339]. *Final decisions of district courts.*

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.

Federal Rules of Criminal Procedure:

Rule 41. *Search and Seizure*

\* \* \* \*

(e) *Motion for Return of Property and to Suppress Evidence.* A person aggrieved by an unlawful search and seizure may move the district court for the district in which the property was seized for the return of the property and to suppress for use as evidence anything so obtained on the ground that (1) the property was illegally seized without warrant, or (2) the war-

rant is insufficient on its face, or (3) the property seized is not that described in the warrant, or (4) there was not probable cause for believing the existence of the grounds on which the warrant was issued, or (5) the warrant was illegally executed. The judge shall receive evidence on any issue of fact necessary to the decision of the motion. If the motion is granted the property shall be restored unless otherwise subject to lawful detention and it shall not be admissible in evidence at any hearing or trial. The motion to suppress evidence may also be made in the district where the trial is to be had. The motion shall be made before trial or hearing unless opportunity therefor did not exist or the defendant was not aware of the grounds for the motion, but the court in its discretion may entertain the motion at the trial or hearing.

### STATEMENT

Since appellants contend that the District Court's findings of fact are clearly erroneous (Br. 25-42), we shall here summarize those findings and the relevant evidence, and shall also state the procedural history of the case.

#### 1. The procedural history

On November 8, 1965, appellants (Jack Goodman and two corporations, Paramount Ice Cream Corporation and Frigid Process Company) filed a complaint in the District Court below against the United States, the United States Attorney, and various officers of the Internal Revenue Service, now appellees, alleging that various documents, copies and property owned by

appellants had been “unlawfully and illegally seized and taken” by appellees Nielsen, Stutz, and Loebig and praying that everything taken (including copies), be returned, that any evidence obtained directly or indirectly from the seized material be suppressed “as evidence against them in any criminal proceeding in this judicial district,” and that the United States Attorney be forever enjoined from seeking an indictment based upon any of the allegedly seized material. (I-A R. 3-5.)<sup>1</sup> The complaint alleged that the action arose under the Fourth, Fifth, and Sixth Amendments to the Constitution and under Rule 41(e) of the Federal Rules of Criminal Procedure. (I-A R. 3.) The complaint was accompanied by, *inter alia*, the affidavits of appellant Goodman (I-A R. 38-43) and of Ruth Myshrall, office manager of Paramount (I-A R. 33-34), and of Evelyn Gedatus, office manager of Frigid (I-A R. 36-37).

Appellees filed an opposition to the complaint entitled “Defendants’ Points and Authorities” (I-A R. 70-86), supported by, *inter alia*, affidavits of appellees Nielsen (I-A R. 89-96), Stutz (I-A R. 103), and Loebig (I-A R. 104). The first document just referred to (I-A R. 70-86) asserted (1) that the complaint should be dismissed for lack of jurisdiction (I-A R. 70-72) and (2) that, in any event, none of appellants’ constitutional rights were violated (I-A R. 73-86). Under the jurisdictional point it was

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<sup>1</sup> “I-A R.” and “I-B R.” references are to Volumes I-A and I-B of the record on appeal. “Tr.” references are to the reporter’s transcript of proceedings in the court below.

stated, *inter alia*, that virtually all of the allegedly seized material had already been returned to appellants and that as yet no indictment had been obtained and no decision had been made as to whether to seek an indictment. (I-A R. 70-72.)

Appellants filed notices to take the depositions of various Internal Revenue Service officers (I-B R. 137-142), but the District Court postponed the taking (I-B R. 146) and ultimately no depositions were taken. Two of the three agents in question testified in the District Court. (See *infra*.)

Appellants caused subpoenas to be served on Internal Revenue Service personnel (I-B R. 179-187, 259-266), calling for the production of all notes, memoranda, and reports of interviews with appellant Goodman and appellants' employees and of conferences or discussions between the investigating agents and their superiors concerning the investigation of appellants and of one James Pinkerton, and calling further for the production of Internal Revenue Service manuals concerning fraud investigations, all policy memoranda on the same subject, and the work diaries and work attendance records of Special Agent Nielsen and Internal Revenue Agent Loebig.

The disposition of these subpoenas is stated, *infra*, under a separate heading.

The District Court denied appellees' motion to dismiss the complaint. (I-B R. 188-189.)

Proceedings were held in the District Court on December 6, 15, and 16, 1965, and January 6, 1966, at which the testimony of appellant Goodman and the investigating agents and others was taken.



On February 8, 1966, the District Court filed findings of fact and conclusions of law (I-B R. 248-254) and entered judgment for the appellees dismissing the complaint (I-B R. 256).

Notice of appeal was filed on February 11, 1966. (I-A R. Index, p. 2, I-B R. 267.)

**2. The District Court's findings of fact and conclusions of law**

The District Court's findings of fact and conclusions of law (I-B R. 248-254) may be summarized as follows:

Paramount Ice Cream Corporation and Frigid Process Company are corporations. Neilsen and Stutz are Special Agents of the Intelligence Division of the Internal Revenue Service and Loebig is an Internal Revenue Agent of the Audit Division, Internal Revenue Service. In April, 1964, Neilsen and Stutz went to Paramount, introduced themselves to appellant Goodman as Special Agents with the Intelligence Division, United States Treasury Department, and explained the difference between a Special Agent and an Internal Revenue Agent. They told Goodman that they were investigating Pinkerton and Paramount and asked to see Paramount's books. Goodman gave them permission to examine any books they wished to see, and they examined the books of Paramount. Some books were taken, and the agents left a document receipt entitled "In Re Jim Pinkerton." (I-B R. 248-250.)

On December 18, 1964, in a continuing investigation of Pinkerton, Nielson returned to Paramount

with Loebig and, because Pinkerton had continued to have transactions with Paramount after 1962, asked Goodman for permission to see Paramount's books for the period subsequent to 1962. Nielsen had re-identified himself to Goodman and had introduced Loebig. Goodman instructed his bookkeeper to make available any books the agents wished to see. The agents micro-filmed some books and took others, leaving a receipt entitled "In Re Jim Pinkerton." No personal questions were asked of Goodman and none of his personal records were requested. (I-B R. 250.)

After returning from Paramount on December 18, 1964, Nielsen was given a preliminary assignment on Goodman so as to interview him concerning his affairs. On December 21, 1964, Nielsen and Loebig re-identified themselves to Goodman and told him that his personal income tax returns were now being investigated. Goodman was told that he had a right against self-incrimination and a right to have an attorney present and that anything he said could be used against him. Goodman stated that he understood his rights, identified six personal income tax returns, and agreed to make available his personal cancelled checks, although he was informed that he was not obliged to do so. He agreed to make available the books of Frigid Process Company. Nielsen also obtained Goodman's permission to examine additional Paramount records as part of the Pinkerton-Paramount investigation. (I-B R. 251.)

On December 23, 1964, Goodman turned over to the agents, at Paramount, his personal cancelled checks,

for which a receipt was given entitled "In Re Jack Goodman." (I-B R. 252.)

On December 30, 1964, and January 4, 5, 6, and 7, 1965, Nielsen and Loebig were at the premises of Frigid Process Company in South Pasadena, examining Frigid's books. Goodman saw them there on several occasions and inquired as to whether everything was being made available. (I-B R. 252.)

In January 8, 1965, Nielsen and Loebig had an interview with Goodman, who was again informed of the privilege against self-incrimination and of his right to counsel. At this interview, Nielsen did not shout or promise leniency or accuse Goodman of lying. After the meeting, Goodman called attorney Alva Baird. (I-B R. 252.)

On January 11 and 12, 1965, Nielsen and Loebig continued to work at Frigid on the corporation's books and records, and on January 12 took some of Frigid's books, leaving a receipt entitled "In Re Jack Goodman and Frigid Process Co." (I-B R. 253.)

Attorney Baird agreed that the agents could keep and work on the books they had until January 25, 1965, and on that date some were returned and Baird gave them permission to continue working on the rest, which were returned subsequently. Baird made additional personal cancelled checks of Goodman available to the agents and cooperated with them as late as June, 1965 (I-B R. 253.)

No fraud, deceit, concealment, or misrepresentation was committed; permission to examine books and records was given voluntarily; no rights of appel-

lants under the Fourth, Fifth, and Sixth Amendments were violated. (I-B R. 253-254.)

### 3. The testimony of appellant Goodman

The testimony of appellant Goodman (Tr. 295-367) may be summarized as follows:

In April, 1964, when he first saw Nielsen and Stutz, Nielsen said that they were from the Internal Revenue Service, but no explanation was given of the difference between a Special Agent and an Internal Revenue Agent. (Tr. 297-298.) He gave the agents permission to examine the records of Paramount. (Tr. 299.) On December 18, 1964, he gave Nielsen and Loebig permission to examine the Paramount records from 1962 to the current date. He was not advised of any constitutional rights. (Tr. 301-302.)

On December 21, 1964, Nielsen and Loebig returned to Paramount and showed Goodman his personal joint income tax returns. Goodman identified the returns and agreed to produce his personal cancelled checks, which he kept at home. He did not ask why the agents wanted these checks, and they did not explain why they wanted him to identify his personal returns. He assumed that they were auditing Pinkerton and Paramount. They advised him of no constitutional rights. (Tr. 304-306.)

On December 23, 1964, the agents came to Paramount and Goodman gave them his personal cancelled checks. Nielsen did not tell him that he was under investigation or advise him of any constitutional rights or tell him that he was not obliged to produce the checks, nor did Nielsen ask for permission to see

the records of Frigid Process Company. (Tr. 308-309.)

During the first week of January, 1965, Goodman saw Nielsen and Loebig at Frigid, examining Frigid's books, but he had no conversation with them until Nielsen asked for a conference, which was arranged for January 8. On January 8, at Frigid, Nielsen questioned him about personal expenses allegedly charged to Frigid, shouted, accused Goodman of lying, told him that he was obliged to answer the questions, and never advised him of any constitutional rights. (Tr. 310-314, 319-320, 354.) Until that moment, he "had taken it for granted that they were investigating Mr. Pinkerton and Paramount Ice Cream Company." (Tr. 353.)

On December 23, 1964, when Goodman turned over his personal cancelled checks, Nielsen gave a documentary receipt for them to Goodman personally. (Tr. 340-341.)<sup>2</sup>

Goodman owns both Frigid and Paramount. He does not own all the stock of Paramount, but has an option to purchase it. (Tr. 320-321.) He owns all the stock of Frigid. (Tr. 324.) He is the president of both corporations. (Tr. 296.)

There was no discussion of his personal affairs or assets on December 21, 1964. (Tr. 335.)

---

<sup>2</sup> This receipt is Plaintiff's Exhibit 4. (I-A R. 64, Tr. 78-79.) It states, *inter alia* (I-A R. 64): "Documents submitted in re: Jack Goodman." It is dated December 23, 1964. The receipt given on December 21, 1964, for records of Paramount stated (Pltf. Ex. 3, I-A R. 63): "Documents submitted in re: James Pinkerton."



Mr. Pinkerton had business relations with Paramount subsequent to 1962. (Tr. 363.)

Goodman never discussed with the agents whether the books of Frigid would be made available to them. (Tr. 363-364.)

Goodman engaged attorney Baird on January 12, 1965. (Tr. 362.)

Goodman was never at any time advised of his constitutional rights. (Tr. 319-320.)

#### 4. The testimony of Special Agent Nielsen

Since the testimony of Special Agent Nielsen (Tr. 6-130, 368-386) was in substance the same as the District Court's findings of fact, we shall attempt to summarize it as briefly as possible. He testified in substance as follows:

In April, 1964, Nielsen was assigned to investigate the tax returns of James Pinkerton (Tr. 9.)<sup>3</sup> He first saw Pinkerton on April 7, 1964, identified himself and Stutz as Special Agents, and told Pinkerton that he was investigating Pinkerton's personal income tax returns. (Tr. 19-20.) Pinkerton stated that he had owned 100 percent of the stock of Paramount, and that the stock which he still owned was being held in escrow. (Tr. 23.) Later the same day Nielsen

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<sup>3</sup> Appellants' counsel stated "that Mr. Pinkerton's ownership of Paramount terminated in mid-'62." Nielsen testified that it did not terminate in 1962, as far as he knew, although Pinkerton had contracted on March 1, 1962, to sell his Paramount stock (evidently to Goodman). (Tr. 42.) After his visits to Paramount in April, 1964 (see *infra*), Nielsen discovered that Pinkerton had continued to have dealings with Paramount subsequent to 1962. (Tr. 43.)

and Stutz introduced themselves to the bookkeeper at Paramount (Ruth Myrshall) as Special Agents and told her that Pinkerton had said that he had no objection to their examining Paramount's records, but that they would not do so until they had Goodman's permission. (Tr. 21-23.)

The next day, April 8, 1964, Nielsen returned to the offices of Paramount with Stutz and introduced himself and Stutz to Goodman as Special Agents with the Intelligence Division, United States Treasury Department. Nielsen said that they were conducting an investigation of James Pinkerton and Paramount and would like to examine Paramount's books. Since Goodman asked, Nielsen explained that an Internal Revenue Agent conducts civil audits and that a Special Agent investigates violations of the internal revenue laws, and whether there has been any attempt to evade or defeat the payment of income taxes. Goodman granted the requested permission to examine Paramount's records. Nielsen did not advise Goodman of any constitutional rights, since Goodman was not under investigation and only corporate records were sought. (Tr. 23, 24, 28, 30.)

The agents examined Paramount's records on April 8, 9 and 21, 1964, and took some records for which they gave a receipt. The corporation's records were in two sets of volumes, one set running from July, 1962, to the then current date. Nielsen did not take these current volumes because he did not wish to cause inconvenience, but he left with the understanding that if he needed them he would return and microfilm them in place. (Tr. 31, 34, 40-41.)



On December 18, 1964, Nielsen returned to Paramount (this time with Loebig) in order to continue the Pinkerton-Paramount investigation, because he had learned since his last visit in April that Pinkerton had continued to have business transactions with Paramount, even after 1962. (Tr. 37, 43.) Nielsen re-identified himself to Goodman and introduced Loebig. (Tr. 37-38.) He told Goodman that Loebig had been assigned to work with him on the Pinkerton-Paramount investigation, and that they wanted to examine and microfilm Paramount's records for the period subsequent to 1962. Goodman stated that he had no objection. (Tr. 38-40.) Nielsen did not advise Goodman of any constitutional rights, because Goodman was not under investigation. (Tr. 62-63.)

Upon returning to his office that afternoon (December 18), Nielsen asked his superior for an assignment sheet in order to make a preliminary investigation of Goodman. (Tr. 53-54.) Accordingly, Nielsen was assigned to make a preliminary investigation to determine whether a full-scale investigation might be warranted. (Tr. 64.)

On December 21, 1964, Nielsen and Loebig returned to Paramount. Nielsen told Goodman that, while the investigation hitherto had been concerned with Pinkerton and Paramount, he had now been assigned to investigate Goodman's personal returns. (Tr. 66-68.) He advised Goodman of the privilege against self-incrimination and of the right to counsel. Goodman said that he had nothing to hide and that Nielsen could "Go ahead and question me." (Tr. 69.) Nielsen showed Goodman his personal returns, which Good-

man identified, and asked about Goodman's sources of income. Goodman said that he owned all the stock of Frigid Process Company, South Pasadena, and 52 percent of the stock of Frigid Process Company, Las Vegas. He said that the records were kept at South Pasadena and it was agreed that the agents could see them there on December 30. (Tr. 69, 73-74.) Nielsen also asked Goodman if he would produce his personal cancelled checks, telling Goodman that he was not obliged to produce them. Goodman agreed to do so. (Tr. 74-75.) When they left, the agents took some Paramount records (deposit tickets) for which they left a receipt entitled "In Re: Jim Pinkerton." (Tr. 70-71.) It was so designated because they took the records for the purposes of the Pinkerton investigation. (Tr. 71-72.)

On December 23, Goodman gave his personal cancelled checks to Nielsen, after again being advised that he was not obliged to do so. A document receipt was given, entitled "Documents submitted in re: Jack Goodman." (Tr. 75-79; Pltf. Ex. 4, I-A R. 64.)

On December 30, 1964, and January 4, 5, 6 and 7, 1965, Nielsen and Loebig were at the premises of Frigid, examining the corporate records. (Tr. 90-97.) Goodman saw them a number of times, and asked if everything was being made available. (Tr. 93-94, 97.) They did not then tell him that they were there to investigate his returns, because they had already told him that before. (Tr. 94-95.)

On January 8, 1965, Nielsen interviewed Goodman concerning his personal tax returns, after again ad-

vising him of the privilege against self-incrimination and telling him that he had the right to have an attorney present. Nielsen did not tell Goodman that he was suspected of a crime. The interview went on for about two hours. Nielsen did not shout or accuse Goodman of lying or promise leniency. As to a few questions, Goodman declined to answer, claiming privilege. He said that he would have to consult an attorney before he decided to give a sworn statement. (Tr. 98-112.)

The agents continued to microfilm Frigid's records on that day, after the interview, and on January 11 (a Monday) and January 12. On January 12, Goodman gave them permission to take certain corporate cancelled checks and bank statements which had not been microfilmed, and a document receipt was given. (Tr. 112-121, 125-126.) All the records taken were corporate records. (Tr. 127.)

On January 19, 1965, attorney Alva Baird agreed that the agents could keep the records until January 25, and later he allowed them to keep some for a longer time. Baird made available to them some of Goodman's personal cancelled checks which they had not seen before, and on June 10, 1965, permitted them to make a further examination of records at Frigid. (Tr. 385-386.)

#### 5. The testimony of other witnesses

Four other witnesses testified before the District Court: Ruth Myshrall (Tr. 207-239), office manager of Paramount; Evelyn Gedatus (Tr. 246-294), office manager of Frigid; Special Agent Stutz (Tr. 402-

420); and Internal Revenue Agent Loebig (Tr. 421-465).

For the sake of brevity, and since the testimony of these witnesses was largely a repetition of parts of the testimony of appellant Goodman and of Special Agent Nielsen, we shall not summarize their testimony here.

**6. The evidence concerning the return of the papers and records here involved**

On the first day of the hearing in the District Court, the Assistant United States Attorney informed the court, without contradiction from appellants' counsel, that she had with her in court "the remaining original documents which would have been returned at any time counsel had asked for them." (Tr. 12.) On the last day of the hearing, appellants' counsel, in oral argument, appears to have conceded that all of the original records involved in this case had been returned to the appellants. (Tr. 472.)

**7. The disposition of appellants' subpoenas calling for records of the Internal Revenue Service**

With reference to appellants' subpoenas calling for the production of diaries, notes, reports, work schedules, manuals, etc., of the Internal Revenue Service (see Section 1, *supra*), the Assistant United States Attorney informed the court that there were "approximately two file cabinets full of this material." (Tr. 14.) She also stated that she had drawn up a list of all the dates mentioned in Special Agent Nielsen's diaries, involving visits to Paramount and talks with Goodman, including "excerpts from memoranda deal-

ing with this aspect of the case." She stated that she would gladly give this to appellants' counsel, but claimed that all other material called for by the subpoenas was both irrelevant and privileged, although she was willing to permit the court to examine it *in camera*. (Tr. 46.) Appellants' counsel explained why he wanted to see all the material called for by the subpoenas. (Tr. 47-49.) The court deferred any ruling. (Tr. 51.) Later, appellants' counsel again explained the purpose of the subpoenas (Tr. 130-131), and the Assistant United States Attorney offered to make available to appellants' counsel "the requisition forms"<sup>4</sup> and the assignment sheets (Tr. 133). Appellants' counsel explained that he wanted to know "when they sought to investigate Pinkerton and when they sought to investigate Goodman and what judgments had to be made and what the judgment was based upon." (Tr. 134.) The Government again offered to make everything available to the court. (Tr. 135.) Thereafter, the requisition forms and

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<sup>4</sup> Special Agent Nielsen testified (as already described, *supra*, under Section 4) that on December 18, 1964, he asked for a preliminary assignment sheet in order to investigate Goodman. (Tr. 53-54.) When asked why he decided to investigate Goodman, he explained that in November, 1964, he requisitioned Goodman's income tax returns to see if he had reported a commission which, according to Paramount's books, had been paid to him. (Tr. 55.) The purpose was to verify the payment for the Pinkerton-Paramount investigation, since many of Paramount's cancelled checks had been destroyed. (Tr. 56.) If he had discovered that Goodman had not reported the commission, he might then have decided to investigate Goodman (Tr. 57), but Goodman in fact had reported the commission (Tr. 61-62).



assignment sheets were produced and were admitted in evidence. (Tr. 390-391, 466.) The court finally denied the appellants' motions to take depositions and denied enforcement of the subpoenas. (Tr. 400-401.)

### SUMMARY OF ARGUMENT

Although the complaint, alleging that agents of the Internal Revenue Service obtained books and records in violation of appellants' constitutional rights, requested that the evidence be suppressed and that the documents be returned, in fact most of the documents had been returned before this action was commenced, and it is undisputed that appellants could have obtained the rest (which were returned during the course of the proceedings below) merely by asking for them. In effect, therefore, the real purpose of this action is to obtain a ruling on the admissibility of evidence in criminal proceedings which, concededly, may never even be commenced. Therefore, the order dismissing the complaint was not a final, appealable order, and this appeal should be dismissed for lack of appellate jurisdiction.

In any event, the District Court correctly concluded that no records or papers were obtained in violation of appellants' constitutional rights.

Most of the records here involved were corporate records, voluntarily produced for the agents' examination. Appellant Goodman, a corporate officer, contends in effect that his consent was obtained by deceit, because the agents did not explain that a Special Agent investigates cases of possible fraud or crime,

because he was not advised of the privilege against self-incrimination or the right to counsel, and because at some point the investigation shifted, without his knowledge, to include him as its subject, rather than only a third person once connected with one of the corporations. It is, however, well established that, where evidence is voluntarily produced, there is no requirement that a Special Agent explain his particular function, nor is he required to warn of rights under the Fifth and Sixth Amendments. A fortiori, no such explanations or warnings are required in the case of corporate records, since they are not protected by the privilege against self-incrimination. As for the contention that appellant Goodman was led to believe that only a third person was under investigation, the District Court found it to be a fact that until a certain date the investigation was not concerned with Goodman, and it further found that when the investigation shifted to include Goodman, he was promptly informed of that shift.

The remaining records consisted of Goodman's personal cancelled checks, but the District Court found on ample evidence that Goodman voluntarily produced them after being told that his personal returns were to be examined, and after being advised of the privilege against self-incrimination and of his right to consult with counsel.

Finally, appellants contend that the District Court erred in quashing their subpoenas calling for the production of internal memoranda, reports, and diaries of the Internal Revenue Service. They assert, in effect, that the production of such material might



have aided them in proving that Goodman became the subject of investigation long before he turned over his personal checks, that no admonition of constitutional rights was ever given, and that from its inception the purpose of the investigation was to obtain evidence of crime or fraud. The subpoenas, however, were properly quashed, if for no other reason than that the evidence sought was wholly immaterial. Since the circumstances show a completely voluntary production of both corporate and personal records, no proof concerning warnings of constitutional rights or explanations of a Special Agent's role was required. Furthermore, it was immaterial when the agents may have decided to investigate Goodman's returns, since he could not have refused to produce the corporate records in any event, and as for his personal cancelled checks, the undisputed fact that the agents asked him to produce them and asked him to identify his own personal income tax returns put Goodman on notice that his returns, at that time, were under investigation, quite aside from the District Court's finding that the agents explained to Goodman that the investigation had been enlarged so as to include him.

## ARGUMENT

### I

**This Action Should Have Been Dismissed as Premature, and for Other Reasons; Furthermore, the District Court's Order Is not Appealable**

According to the complaint (I-A R. 5), the purpose of this action was to obtain the return of appellants' records, and copies thereof, and to suppress the use

of such records and copies, and evidence obtained directly or indirectly from them, in any criminal proceeding against appellants. It is, however, undisputed that most of the original records were returned before the action was brought, and evidently all other such records were returned while the hearing in the District Court was in progress, and would have been returned before the commencement of this action if appellants or their attorneys had asked for them. (Tr. 12, 472). It is also undisputed that this action was brought before indictment and before the initiation of any criminal proceedings whatever. Indeed, the Assistant United States Attorney stated in the District Court that the Government had not yet even decided that any criminal proceedings would ever be brought. (Tr. 50-51.)

In short, insofar as the question of appealability is concerned, this case is indistinguishable from *Hill v. United States*, 346 F. 2d 175, where this Court held that an order dismissing proceedings of the same kind as here involved is not appealable where, before appeal is taken, all records have been returned, so that the action no longer has any purpose except to obtain a ruling on the admissibility of evidence in a possible future criminal proceeding which may never even be commenced. See, also, *DiBella v. United States*, 369 U.S. 121, 131-132. Accordingly, we submit that this appeal is governed by *Hill v. United States*, *supra*, and that it should be dismissed for lack of appellate jurisdiction.

Furthermore, concerning the jurisdiction of the District Court to entertain this action, it may be in-

ferred from the opinion in *Hill v. United States, supra*, that—since the real purpose of this action was never to obtain the return of appellants' records or property, inasmuch as they could have had them for the asking—the District Court would not have abused its discretion if it had dismissed the complaint as prematurely brought, without considering at all the merits of the allegations concerning illegality in the Government's original acquisition of appellants' records, for this Court said in that case (p. 178):

All that remains on this attempted appeal is the district court's order denying appellant's motion to suppress evidence. Since this attempt to suppress evidence has developed before any action has even been commenced, and, for that matter, has developed where an action may never even be commenced, we find this motion is nothing more than a premature request. If a criminal prosecution does subsequently take place, appellant can raise a motion to suppress any evidence which the government may have secured in violation of his constitutional rights.

A comparable case is *Gentilli v. Caplin*, decided by the United States Court of Appeals for the District of Columbia Circuit on March 3, 1964 (64-2 U.S.T.C., par. 9779). There,<sup>5</sup> the taxpayer filed a complaint, designated alternatively as a bill in equity or a motion under Rule 41(e) of the Federal Rules of Crim-

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<sup>5</sup> Since the District Court rendered no opinion (see 64-2 U.S.T.C., par. 9778, for the District Court's order), and the Court of Appeals failed to recite the facts, we refer to the original pleadings filed in the Court of Appeals.

inal Procedure, alleging the taking of records by agents of the Internal Revenue Service by unconstitutional search and seizure, and praying that the records and evidence be ordered suppressed for all purposes, including use in any criminal proceeding which might be brought and in any proceedings in the Tax Court. The action was brought against the Commissioner of Internal Revenue, the United States Attorney, and the Attorney General. The District Court granted defendants' motion for summary judgment (*Gentilli v. Caplin* (D.C. D.C.), decided November 26, 1962 (64-2 U.S.T.C., par. 9778)), and the Court of Appeals affirmed in a *per curiam* opinion (64-2 U.S.T.C., par. 9779) as follows (omitting the formal introductory sentence) :

On consideration whereof It is ordered and adjudged by this Court that the judgment of the District Court appealed from in this case be, and it is hereby, affirmed without prejudice, however, to appellant's urging his objections to the use by the government of the documents in suit in some subsequent appropriate proceeding. See *Reisman v. Caplin*, 375 U.S. 440 (1964).

Since *Reisman v. Caplin*, 375 U.S. 440, involved an action by a taxpayer to quash an Internal Revenue summons for the production of books and records, but the *Gentilli* case was an action to suppress evidence which the Government already had, the reference in the *Gentilli* opinion quite evidently was to the basic proposition adopted in *Reisman v. Caplin*, *supra*, p. 443, *viz.*, that the complaint (in *Reisman*) was properly dismissed, not necessarily for the reasons adopted

by the District Court, but because the taxpayer had an adequate remedy at law. That remedy was that, if and when the Government should bring an action to enforce the summons, the taxpayer could intervene and oppose the action and, if unsuccessful, could appeal. In *Gentilli v. Caplin*, as in the instant case, the Internal Revenue Service already had the evidence sought to be suppressed, but no extraordinary equitable remedy in advance of any attempt to use the evidence is required, since the complaining taxpayer already has an adequate remedy at law, i.e., he may wait until the Government seeks to use the evidence in a criminal or civil case in the district court or in a Tax Court proceeding and may then make appropriate objection or move to exclude the evidence, and may appeal from any final, adverse decision in the case.

In sum, we submit that the District Court could well have dismissed the present action on the ground that it was prematurely brought, and that, in any event, this appeal should be dismissed, as in the case of *Hill v. United States*, *supra*, for lack of a final, appealable order.<sup>6</sup>

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<sup>6</sup> It may at least be noted that, since appellants asked for the return of all *copies* which the appellees might have, such relief should in any event be denied as requiring a premature intervention by the courts in the process of tax assessment and collection. See *Zamaroni v. Philpott*, 346 F. 2d 365 (C.A. 7th) ; cf. *Kennedy v. Coyle*, 352 F. 2d 867 (C.A. 7th).



## II

**On Factual Findings Fully Supported by the Evidence, the District Court Correctly Concluded That Appellants Suffered no Violation of Constitutional Rights**

In the event that this appeal is not dismissed for lack of jurisdiction (see Part I, *supra*), we turn now to the merits of the case.

A cardinal fact in this case is that a great part of the evidence which appellants seek to suppress consists of *corporate records*. Between April 8, 1964, when the first examination of any records took place (I-B R. 249-250; Tr. 23-24), and January 12, 1965, when Goodman retained attorney Alva Baird (I-B R. 253; Tr. 362), the agents (with Goodman's consent) examined, copied, and in some instances took with them only the corporate records of Paramount and Frigid (see Statement, *supra*), with one exception. The exception occurred on December 23, 1964, when Goodman turned over to the agents his personal cancelled checks. (I-B R. 252; Tr. 75-79, 308-309.) After January 12, 1965, attorney Alva Baird made available to the agents some of Goodman's personal cancelled checks which they had not seen before. (I-B R. 253; Tr. 385-386.)

There is obviously a considerable difference between personal papers and corporate records with respect to constitutional immunities; we shall consider the two categories separately.

**A. *The corporate records***

Our chief purpose will be to consider the corporate records in the light of the District Court's findings

of fact, but we shall also consider (since appellants complain (Br. 14-21) of the failure to enforce their subpoenas) whether the result would be any different if appellants' alleged suspicions (e.g., Br. 21-24) and Goodman's testimony (Tr. 295-367) were accepted as correct.

At the outset, it may be noted that the District Court's findings of fact (I-B R. 248-254) were fully supported by the testimony of all the agents who actually participated in the examination, copying and taking of records (Tr. 6-130, 368-386, 402-420, 421-465.) See the Statement, *supra*. Appellants contend (Br. 25-42) that the court's findings were clearly erroneous, but in effect they seek nothing less than a trial de novo, contrary to the rules governing appellate review. See, e.g., *Baumgardner v. Commissioner*, 251 F. 2d 311, 313 (C.A. 9th); *United States v. Gypsum Co.*, 333 U.S. 364, 395. Clearly, it was within the province of the District Court to judge as to which witnesses were telling the truth; and we submit that on the record in this case Goodman's testimony is, to say the least, difficult to believe. One example may suffice. Goodman testified that on December 21, 1964, Nielsen and Loebig returned to Paramount, showed him the personal joint income tax returns filed by him and his wife, asked him to identify the returns, and asked him to produce for examination his personal cancelled checks. Yet he testified that he did not ask them why, in the circumstances, they wanted to see the checks, that they did not explain why they wanted him to identify the returns, and that he assumed that they were merely pursuing



their audit of Pinkerton and Paramount. (Tr. 304-306.) His testimony was to the same effect with reference to December 23, when he actually delivered his checks to them. (Tr. 308-309.) This testimony would seem inherently incredible. Nielsen's testimony was entirely to the contrary, including his testimony that on December 21 he explained to Goodman that he had now been assigned to investigate Goodman's personal returns. (Tr. 66-68.)

We turn now to the District Court's findings. It found, *inter alia*, that on April 8, 1964, Nielsen informed Goodman that he and Stutz were investigating Pinkerton and Paramount, and that with Goodman's permission they examined *the corporation's records* on April 8, 9, and 21, and on April 21 took some of the records with them, leaving a receipt. (I-B R. 249-250.) Goodman agreed with these findings (Tr. 297-300), and his only cavil now is that he allegedly thought that the agents were merely conducting an audit, that he did not know the role of a Special Agent, and that he was not advised of any constitutional rights (e.g., Br. 24, 50). Nielsen agreed that he gave no warning of constitutional rights, but testified that he explained the difference between an Internal Revenue Agent and a Special Agent. (Tr. 24-30.) On either of these versions of the events of April, 1964, obviously no violation of anyone's constitutional rights occurred. Neither a corporation nor its officer in possession of its records may refuse to produce the records of the corporation, whether such records may incriminate the corporation or the officer or both. See, e.g., *Wilson v. United States*, 221 U.S. 361; *Wheeler*

v. *United States*, 226 U.S. 478; *United States v. White*, 322 U.S. 694.

Since neither Goodman nor the corporation had any right to prevent the examination of the corporate records, obviously there was no occasion to warn Goodman of his *personal* privilege against self-incrimination or right to counsel. A warning of the latter right was adopted as a rigid requirement in *Miranda v. Arizona*, 384 U.S. 436, but only as a means of fortifying the free choice envisaged by the self-incrimination privilege (in situations where an accused person—i.e., one whom the police are seeking to incriminate—is subjected to the pressures of an in-custody interrogation.) Here, there was no self-incrimination privilege to be thus fortified or supplemented; furthermore, Goodman was not under arrest and was not an accused person. Cf. *Kohatsu v. United States*, 351 F. 2d 898 (C.A. 9th), certiorari denied, June 20, 1966 (34 U.S. Law Week 3429). Indeed, Goodman was not even under investigation, according to the District Court's findings and the agents' testimony, and appellants do not seriously contend otherwise. But even if the opposite were supposed, neither Goodman nor the corporation (Paramount) suffered any loss of rights, since neither had any right to withhold the corporate records from the agents' examination.

After the events of April, 1964, no records of any kind were seen until December 18, 1964. (I-B R. 250; Tr. 37, 43-44.) On that day the agents returned for a further examination of Paramount's records, because they had discovered that Pinkerton had continued to do business with Paramount even after 1962,

although Goodman apparently had held the dominant or active role in the corporation since March, 1962. (I-B R. 250; Tr. 37-43, 320-324, 363.) For the reason stated, current or post-1962 corporate records were examined and taken, with Goodman's permission. (I-B R. 250; Tr. 40, 44.) On these facts, for the same reasons as stated above, no warnings of constitutional rights were required, since only corporate records were examined or taken. True, Goodman strongly voices his suspicion that the agents already had their eyes on him (Br. 32), but, if so, the fact is immaterial. A corporate officer has no right to withhold corporate records relevant to a lawful federal tax investigation, no matter who ultimately may be incriminated. See, e.g., *Wilson v. United States*, *supra*.

On December 21, 1964, the agents took more of Paramount's books, with Goodman's permission. (I-B R. 251.) The situation was not different from that of December 18, except that on December 21 the agents also inquired into Goodman's personal tax liabilities and asked to see his personal cancelled checks (matters to be discussed separately, *infra*).

Next, the corporate records of Frigid were examined on December 30, 1964, and on January 4, 5, 6, 7, 8, 11, and 12, 1965. (I-B R. 252-253.) Goodman testified that no warnings of constitutional rights were given at any time, and that only on January 8 did he at last learn, during a stormy interview, that he had become the target of the investigation. (Tr. 310-314, 319-320, 354.) Yet according to his own testimony he was the president and sole stockholder of

Frigid (Tr. 296, 324), and the record shows no interest of Pinkerton in that corporation at any time.

Clearly, for the reasons already stated, no constitutional rights were violated since only corporate records were involved. Appellants cite (Br. 21, 24) *Gouled v. United States*, 255 U.S. 298, where evidence was suppressed because the complainant was deceived into admitting to his premises an old friend, not known by him to be now a Government agent, and the ostensible friend then secretly removed the complainant's private (not corporate) papers. But in the instant case, if Goodman thought that Nielsen and Loebig were investigating only Pinkerton (an incredible supposition), his misapprehension was of no moment, since neither he nor the corporation had any right to prevent the examination, no matter who might be incriminated. To be sure, a corporation need not submit to an unconsented breaking and entering into its premises and the rifling of its records. *Silverthorne Lumber Co. v. United States*, 251 U.S. 385. But we submit that Government agents who identify themselves as such and examine corporate records with permission obviously commit no unreasonable search and seizure, even if a corporate officer may later and irrelevantly claim that he thought that an examination of his wholly owned corporation was solely in furtherance of an investigation of some other person wholly unconnected with the corporation. If Goodman thought any such thing, the agents certainly were entitled to assume otherwise. If the ownership status of Frigid did not clinch the point, the record also contains the receipt given on

December 23, 1964, for Goodman's personal cancelled checks, bearing the words "Documents submitted in re: Jack Goodman." (Pltf. Ex. 4, I-A R. 64; Tr. 78-79.) This receipt was handed to Goodman personally on December 23, 1964, as Goodman himself admitted. (Tr. 340-341.)

Goodman also contends that he was deceived because he was never told that the investigation was a "criminal investigation." (Br. 22.) However, even where oral admissions or personal records (as to which the self-incrimination privilege can be invoked) are obtained by a Special Agent during a tax investigation, absent elements of fraud and deception the agent is not required to warn the taxpayer that he is investigating the possibility of criminal fraud; nor is he required to warn the taxpayer that his statements or documents can be used against him in a criminal case; the oral admissions and personal records are usable for all subsequent tax purposes (civil and criminal) if, in fact, the admissions were voluntarily made and the records voluntarily delivered to an identified investigating agent of the internal Revenue Service. *Kohatsu v. United States*, *supra*; *Greene v. United States*, 296 F. 2d 841, 843 (C.A. 2d), vacated and remanded on other grounds, 369 U.S. 403; *Montgomery v. United States*, 203 F. 2d 887, 893 (C.A. 5th); *United States v. Burdick*, 214 F. 2d 768, 773-774 (C.A. 3d), vacated and remanded, 348 U.S. 905, affirmed on remand, 221 F. 2d 932, certiorari denied, 350 U.S. 831; *United States v. Sclafani*, 265 F. 2d 408, 414-415 (C.A. 2d), certiorari denied, 360 U.S. 918; *Turner v. United States*, 222 F. 2d 926, 931-



932 (C.A. 4th), certiorari denied, 350 U.S. 831. See also (although not involving Special Agents) *Hanson v. United States*, 186 F. 2d 61, 64-66 (C.A. 8th), and *Scanlon v. United States*, 223 F. 2d 382, 384-385 (C.A. 1st).

A fortiori, insofar as the corporate records of Paramount and Frigid are concerned, the agents were not required to advise Goodman that a criminal investigation or fraud investigation was underway, since neither he nor the corporations had any right to refuse to produce those records, regardless of who might be incriminated.

In short, no violation of any constitutional rights occurred with respect to the examining, copying, or taking of the *corporate* records of Paramount and Frigid, in light of the findings of fact made by the District Court; and the conclusion must be the same even if Goodman's version of events is taken as correct.

#### **B. Goodman's private papers**

Nothing remains to be considered except Goodman's delivery of his personal cancelled checks to the agents on December 23, 1964. (I-B R. 252.) The District Court found (I-B R. 251-252), in accordance with Nielsen's testimony (Tr. 53-79), that after returning from Paramount on December 18, 1964, Nielsen was given a preliminary assignment to investigate Goodman, and that on December 21, Nielsen (after identifying himself by his title and showing his commission) told Goodman that now his personal income tax returns were under investigation and advised Good-

man of the privilege against self-incrimination and the right to have an attorney present. Goodman stated that he understood his rights and identified six personal income tax returns. He agreed to make his personal cancelled checks available, after being told that he was not obliged to do so. On December 23, 1964, Goodman delivered the checks to the agents at Paramount and received a receipt made out "In Re Jack Goodman." On the basis of the foregoing findings of fact, obviously no constitutional rights were violated. Being fully advised of his rights, and with two days in which to decide whether to consult an attorney, Goodman voluntarily handed over his checks. Since the court's findings were fully supported by competent evidence, there should be no need to dwell now upon the different set of facts alleged by Goodman, except for his contentions that the findings are clearly erroneous (Br. 25-42) and that the case should be remanded for the enforcement of his subpoenas (Br. 14-21).<sup>7</sup>

Appellants' contentions are, in substance, that on December 21 and December 23, 1964, he still believed that the agents were investigating only Pinkerton, or Pinkerton and Paramount; that the agents never informed him to the contrary until January 8, 1965; that, furthermore, he did not know what the functions of a special Agent were, or that fraud or crime was the subject of the investigation; and that he was never at any time advised of the privilege

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<sup>7</sup> We discuss the matter of the subpoenas under Part III, *infra*.



against self-incrimination or the right to counsel. He also contends (Br. 32) that Nielsen had decided to investigate him as early as November, 1964. Otherwise stated, the contentions are that evidence derived from Goodman's personal cancelled checks should be suppressed (1) because he was deceived into believing that only Pinkerton was under investigation, with the result that there was a taking without his consent and hence an unreasonable search and seizure; (2) because he was not informed that the possibility of fraud or crime was under investigation, with the same result just stated; and (3) because he was not warned of the privilege against self-incrimination or the right to counsel.

As for the first contention, the answer is that the District Court found that Goodman was told on December 21 that he was then under investigation, during the same meeting when he was asked to produce the checks. (I-B R. 251.) Furthermore, as previously submitted, *supra*, Goodman's contrary testimony is, on its face, incredible. Admittedly, on December 21 Nielsen (for the first time) showed Goodman his personal income tax returns and asked him to identify them, and then asked whether Goodman would permit him to examine his personal cancelled checks. No claim is made that only certain checks were asked for, which might somehow pertain to Pinkerton. Under these circumstances, it is hardly likely that Goodman could have supposed that Pinkerton alone was the subject of the agents' investigation, even if it were assumed that Nielsen said nothing about any purpose to examine into the correctness of Goodman's returns.

Furthermore, even if it were assumed, *arguendo*, that Goodman did imagine that the agents were not interested in him or his returns, Nielsen could have been in no position to realize that Goodman had any such belief, since the mere act of showing Goodman his returns and asking for his personal cancelled checks would seem to be sufficient to inform any ordinary taxpayer that *his* tax returns and his tax liabilities were under scrutiny. The short of the matter, however, is that it is difficult to see how Nielsen could have inquired for the first time into Goodman's personal returns and checks without making some explanation, and certainly the District Court was fully justified in rejecting Goodman's testimony (Tr. 304-306) that he (Goodman) asked no questions and that no explanation was given.

The second contention is that Goodman was not informed that the possibility of fraud or crime was under investigation. As already shown (under Part A, *supra*), it is well established that a Special Agent is not required to give any such explicit advice, it being sufficient if the taxpayer's giving of statements or the production of documents is entirely voluntary. There is no deception and no resulting absence of consent, although the role of a Special Agent is not explained, because any ordinary taxpayer undoubtedly realizes that tax investigators will explore or take note of every aspect of his returns, and surely will inquire into the reason for false deductions or unreported income and into the question of whether the discrepancies were willful or merely inadvertent.

That is the rationale of the cases previously cited. See, e.g., *Kohatsu v. United States*, *supra*; *United States v. Sclafani*, *supra*.

The third contention is that Goodman was not advised of the privilege against self-incrimination or of the right to counsel. The District Court found, however, that he was advised of both rights on December 21, when he agreed that he would make his personal cancelled checks available. (I-B R. 251.) Furthermore, there would have been no unreasonable search and seizure, and hence no right to suppress,<sup>8</sup> even if the facts were assumed to be otherwise. In *Kohatsu v. United States*, *supra*, the same contention was made (see 351 F. 2d p. 899), but this Court held that the taxpayer's documents were admissible at the taxpayer's trial for tax evasion even though the agents (including a Special Agent) had obtained them from the taxpayer without advising him of the privilege against self-incrimination or the right to counsel. This Court, distinguishing *Escobedo v. Illinois*, 378 U.S. 478, noted (p. 901) that in *Kohatsu* the accusatorial stage had not been reached, since the agents (as in any tax investigation) were not seeking to identify a person in custody as the perpetrator of an unsolved crime, but were investigating to determine "whether in fact any crime had been

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<sup>8</sup> Rule 41(e) of the Federal Rules of Criminal Procedure, *supra* is based upon violations of the Fourth Amendment right. See, also, *Centracchio v. Garrity*, 198 F. 2d 382 (C.A. 1st), certiorari denied, 344 U.S. 866; *Biggs v. United States*, 246 F. 2d 40 (C.A. 6th), certiorari denied, 355 U.S. 922; cf. *In re Fried*, 161 F. 2d 453 (C.A. 2d).

committed." In the instant case, obviously Special Agent Nielsen was engaged in the same task. Indeed, he was merely commencing his investigation of Goodman, since he never obtained any of Goodman's personal records (the personal cancelled checks) until December 23 (I-B R. 252), and even on December 18 he had been given only a preliminary assignment to investigate to see whether a full investigation of Goodman might be warranted (Tr. 53-54, 64).

In short, this third contention, like the second, is entirely governed by *Kohatsu*. Furthermore, in *Miranda v. Arizona*, *supra*, the Supreme Court said nothing which would tend to support a contrary result. The entire thrust of *Miranda* was directed toward confessions and admissions which are not truly voluntary because made by a person in custody or under some kind of restraint. As the Court said (384 U.S., p. 478), "Volunteered statements of any kind are not barred by the Fifth Amendment and their admissibility is not affected by our holding today." In the instant case, Goodman's production of his personal cancelled checks was completely voluntary, even on the basis of his own testimony (except for his claim of deceit, already dealt with, *supra*). He was asked for his checks on December 21, and on December 23 he turned them over to the agents at his office. (I-B R. 251-252.) He was entirely free to see an attorney, or to delay as long as he liked in the matter of finding or delivering the checks. It is significant, in this regard, that even after Goodman had retained counsel, the latter made additional personal cancelled checks

available to the agents and cooperated with them as late as June, 1965.

In sum, there was no violation of constitutional rights with respect to *any* of the records, papers, checks, or other documents involved in this case.

### III

#### **The District Court Did Not Err in Denying Enforcement of Appellants' Subpoenas**

Appellants contend (Br. 14-21) that the District Court erred in granting appellees' motion to quash appellants' subpoenas duces tecum. These subpoenas called for the production of all notes, memoranda, and reports of interviews with appellant Goodman and appellants' employees and of conferences or discussions between the investigating agents and their superiors concerning the investigation of appellants and of Pinkerton, the work diaries and work attendance records of Special Agent Nielsen and Internal Revenue Agent Loebig, and Internal Revenue Service policy memoranda and internal manuals concerning fraud investigations. (I-B R. 178-187, 259-266.) Appellants contend (Br. 16-18) that the production of this material would have aided them in showing (1) that no admonition of constitutional rights was given; (2) the exact time when the investigation first included Goodman; (3) that the investigation was a criminal investigation from its inception and "was never concerned with anyone's civil tax liabilities" (Br. 17); and (4)—actually a point subsidiary to (2), *supra*—"that the case assignment sheet (dated December 18, 1964) (Exhibit 8) was actually pre-



pared prior to the interview of Mr. Goodman on this day" (Br. 18).

Clearly, the District Court did not err in quashing the subpoenas, because it was completely unreasonable to expect that the proposed fishing expedition would produce any relevant evidence. We turn to examine appellants' alleged purposes. (Br. 16-18.)

First, they seek to justify the subpoenas by saying that the memoranda, reports, diaries, etc., might aid them in proving that no admonition of constitutional rights was given. (Br. 16.) We have already shown, however, that no such admonition was required, even as to Goodman's personal cancelled checks, since his delivery of the checks, on the undisputed facts, was completely voluntary.

Secondly, appellants contend that the material sought by the subpoenas would show that Goodman "was the subject of a criminal investigation prior to December 21, 1964" (Br. 17), indeed, prior to December 18, 1964 (Br. 18). But even if that were shown, the fact would be immaterial. No matter when Goodman came under investigation with respect to the possibility of his having perpetrated fraud or having committed crime, nothing which he could have withheld was obtained by the agents until December 23, when he turned over his personal cancelled checks. As to whether he was then the subject of a special agent's investigation, there is no dispute.

Thirdly, appellants contend that the subpoenas, if honored, would show "that this investigation \* \* \* was a criminal investigation from its inception and was never concerned with anyone's civil tax liabili-

ties." (Br. 17.) But it may be conceded that, like any special agent, Nielsen was concerned with the *possibility* that fraud and even criminal activity, first with respect to Pinkerton and then with respect to Goodman, might ultimately be disclosed. The agents here were identified from the outset; their duties require no redundant proof. See *Kohatsu v. United States*, *supra*; *Boren v. Tucker*, 239 F. 2d 767 (C.A. 9th); *United States v. Lipshitz*, 132 F. Supp. 519, 521 (E.D. N.Y.); Notice, Treasury Department, Internal Revenue Service—Organization and Functions, Sec. 1118.6 (26 Fed. Register, Part 7, pp. 6372, 6393). The imposition of civil fraud penalties and the establishment of criminal liability as ultimate theoretical possibilities of course require investigation into true basic tax liability.

To require, in the circumstances of this case, the enforcement of the subpoenas here involved in effect would permit appellants, by merely voicing suspicions<sup>9</sup> when no criminal proceedings are pending, to obtain more than the recently liberalized Federal Rules of Criminal Procedure allow a defendant under indictment to obtain by way of discovery. Rule 16(b) of those rules, as amended, effective July 1, 1966, provides that the discovery permitted by that rule, except for reports of medical or scientific examinations—

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<sup>9</sup> Compare *Lawn v. United States*, 355 U.S. 339, where the Court held that the trial court in a criminal case was not required to conduct a full-dress hearing based on the defendants' suspicion that evidence obtained in violation of constitutional rights had been presented to the grand jury.



does not authorize the discovery or inspection of reports, memoranda, or other internal government documents made by government agents in connection with the investigation or prosecution of the case, or of statements made by government witnesses or prospective government witnesses (other than the defendant) to agents of the government except as provided in 18 U.S.C. § 3500.

### CONCLUSION

For the foregoing reasons, either this appeal should be dismissed or the order of the District Court should be affirmed.

Respectfully submitted,

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August, 1966.

### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: \_\_\_\_\_ day of August, 1966.

JOHN A. SMITH, Attorney

No. 20811

IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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JACK GOODMAN, PARAMOUNT ICE CREAM )  
CORP. and FRIGID PROCESS CO., (

Appellants, (

vs. (

UNITED STATES OF AMERICA, et al., (

Appellees. (

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APPELLANTS' REPLY BRIEF

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**FILED**

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WM B HANCOCK JR



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No. 10011

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CORP. and FRIGID PROCESS CO., (

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Appellees. (

APPELLANTS' REPLY BRIEF

PRELIMINARY STATEMENT

Appellants will utilize their opportunity to  
file this Reply Brief by analyzing and refuting  
appellees' arguments as set forth in the Brief for the  
appellees (hereinafter "Appellees' Brief") and by  
summarizing appellants' various arguments.

I

JURISDICTION

A. The District Court Had Jurisdiction.

Appellees suggest that it would have been



1 proper For the District Court to have dismissed the present  
2 action on the grounds of prematurity. Not only is this  
3 contention irrelevant to these proceedings, but the  
4 authorities cited by appellees are either dictum, (Hill v.  
5 United States, 346 F.2d 175 (9th Cir. 1965)), inapplicable  
6 and distinguishable (Reisman v. Caplin, 375 U.S. 440, 13  
7 AFTR 2d 457 (1964)), or sufficiently indefinite so as  
8 to deprive the case of any precedent value (Gentilli v.  
9 Caplin, D.C. Cir., decided March 3, 1964 (64-2 U.S.T.C.  
10 ¶9779)).

11 To the contrary, there is substantial authority  
12 to the effect that a motion to suppress may be brought  
13 prior to indictment. See e.g., DiBella v. United States,  
14 369 U.S. 121 (1962); Go-Bert Importing Co. v. United States,  
15 382 U.S. 344, 355 (1931); Hoffritz v. United States, 240  
16 F.2d 109 (9th Cir. 1956); In Re Fried, 161 F.2d 453,  
17 458-459 (2d Cir. 1947); Smith v. Kotzenbach, 331 F.2d 810  
18 (D.C. Cir. 1965).

19 B. The Judgment Of The District Court Is A  
20 Final, Appealable Order.

21 Appellees argue that the decisions in Hill  
22 and DiBella bar this appeal. A careful examination of  
23 these decisions and the factual distinctions between them  
24 and the case presently before this Court establishes that  
25 the judgment of the district court was a final, appealable  
26 order.



1 Prior to DiBella, there were many cases holding  
2 that preindictment motions seeking the return of property  
3 unlawfully obtained and its suppression as evidence in  
4 any future criminal proceeding were appealable. See e.g.,  
5 Perlman v. United States, 247 U.S. 7 (1917); Burdeau v.  
6 McDowell, 256 U.S. 465 (1920); Lapides v. United States,  
7 215 F.2d 253, 254-55 (2d Cir. 1954); In Re Fried, supra;  
8 In Re Sano Laboratories, 115 F.2d 717, 718 (3rd Cir. 1940);  
9 Dowling v. Collins, 10 F.2d 62 (6th Cir. 1926). This same  
10 principle was followed in this Circuit. In United States v.  
11 Rosenwasser, 145 F.2d 1013, 1016-17 (9th Cir. 1944), this  
12 Court stated that:

13 "Where no criminal action against him  
14 is pending at the time the moving party  
15 institutes a proceeding to suppress evidence,  
16 the proceeding is considered an independent  
17 suit in equity and the court's order therein  
18 is appealable as a final decision."

19 See also, Weldon v. United States, 190 F.2d 874, 875 (9th  
20 Cir. 1952); Freeman v. United States, 180 F.2d 69 (9th Cir.  
21 1946).

22 In DiBella, the Supreme Court's primary con-  
23 sideration was the distinction between motions for the  
24 suppression of evidence which were made while there was a  
25 criminal prosecution in esse and independent civil  
26



1 proceedings seeking the return of illegally seized property  
2 which were instituted while there was no criminal prosecution  
3 in esse. After examining the policy considerations against  
4 allowing appeals during the course of criminal proceedings,  
5 the Supreme Court formulated the following standard:

6 "When at the time of ruling there is  
7 outstanding a complaint, or a detention  
8 or release on bail following arrest, or  
9 an arraignment, information, or indictment--  
10 in each such case the order on a suppression  
11 motion must be treated as 'but a step in  
12 the criminal case preliminary to the trial  
13 thereof.'" 369 U.S. at 131. (Emphasis supplied.)

14 In the absence of all of the above factors, it  
15 must logically follow that there is no prosecution in esse  
16 and hence, an independent proceeding.

17 In order to assist in the determination of  
18 whether the proceeding was an independent proceeding, the  
19 Supreme Court, in addition to its requirement that there  
20 be no criminal prosecution in esse, imposed a further  
21 requirement that the motion seek solely the return of  
22 property as distinguished from the suppression of evidence.

23 In Hill, this Court approved the following para-  
24 phrasing of DiBella:

25 " 'DiBella requires both a request for  
26 return of property and independence from





1 the criminal case before the order  
2 denying return becomes appealable."

3 (Emphasis in original.) 346 F.2d at 178.

4 Although the facts in Hill clearly established  
5 "independence from the criminal case", i.e., no prosecution  
6 in esse, this Court held that since all of Dr. Hill's  
7 books and records had been returned, the motion constituted  
8 merely a motion to suppress and, as such, did not meet  
9 the requirements of DiBella.

10 In the instant case, appellants' independent  
11 civil action, which was commenced before the initiation  
12 of any criminal proceedings, was brought as an action  
13 seeking return of all property which was unlawfully taken.  
14 The fact that the originals of the books, records and  
15 other documents were returned (after the commencement of  
16 these proceedings) does not constitute a return of all of  
17 appellants' property since extensive copies were made  
18 without appellants' knowledgeable approval while the  
19 books, records and other documents were in the possession  
20 of the government agents. That these copies constitute  
21 the property of appellants and are recoverable by them  
22 cannot be questioned. As Judge Learned Hand stated in  
23 United States v. Kraus, 270 Fed. 578, 580 (S.D.N.Y. 1921):

24 "The law in cases of unlawful searches  
25 is now well settled. . . . When seized they  
26 [the documents] must be returned, with them



1        all copies taken while the officers  
2        retained their illegal possession."

3        (Emphasis supplied.)

4        And in Rosenwasser, this Court stated, at 1017-18:

5                "'The essence of a provisions for-  
6        bidding the acquisition of evidence in a  
7        certain way is that not merely evidence  
8        so acquired shall not be used before the  
9        Court but that it shall not be used at  
10       all.' We think the same theory applies  
11       to that part of the order in the instant  
12       case requiring the officers and agents of  
13       the Wage and Hour Division to return any  
14       copies or information obtained from the  
15       property illegally seized and requiring  
16       the United States to refrain from using  
17       any data so obtained." (Emphasis supplied.)

18       See also Silverthorne Lumber Co. v. United States, 251 U.S.  
19       385 (1920). Although the Court in Hill discussed the  
20       effect of the copies in the possession of the government,  
21       the motion in that case could not validly seek the return  
22       of copies since, by voluntary arrangement and with court  
23       approval, the parties "permitted the government first to  
24       make copies of what it deemed relevant." 346 F.2d at 177.

25       (Emphasis supplied.)

26       The instant case is markedly different from Hill



1 since there was never any voluntary arrangement which  
2 permitted the government to copy appellants' records.

3 Appellees contend that since appellants' original  
4 books and records have been returned they should not  
5 complain merely because copies have been made thereof by  
6 appellees. If this position is accepted it would mean that  
7 government agents would be free to break into a person's  
8 home without a valid warrant while he is absent and photo-  
9 copy his records without removing them from the premises.  
10 If this conclusion is not patently wrong, search warrants  
11 will become a thing of the past. It must follow, especially  
12 since under section 1732 of Title 28 of the United States  
13 Code, photocopies are as equally admissible as originals,  
14 that copies of appellants' records are as much their  
15 property as the originals from which they were produced.

16 Zamaroni v. Philpott, 346 F.2d 365 (7th Cir. 1965),  
17 and Kennedy v. Coyle, 352 F.2d 867 (7th Cir. 1965), cited  
18 by appellees at p. 24, footnote 6 are totally inapplicable  
19 since they are concerned solely with judicial interference  
20 in civil administrative procedures.

21 Therefore, since there is no prosecution in esse  
22 and since appellants are seeking the return of property,  
23 not only is the philosophy of DiBella clearly met, but  
24 this Court's interpretation of DiBella as set forth in Hill  
25 is likewise satisfied.

26 It is further significant to note that had





1 appellants refused to produce the books and records  
2 requested and the government proceeded in accordance with  
3 section 7602 of the Internal Revenue Code of 1954, as  
4 amended, appellants could have appealed from a District  
5 Court's enforcement of the subpoena. Rule 81(a)(3), Fed.  
6 R. Civ. P.; Reisman v. Caplin, supra. The right to appeal  
7 should not be lost merely because of such a formal dis-  
8 tinction.

## 9 II

### 10 SUBPOENAS DUCES TECUM

11 Appellees' argument supporting the District  
12 Court's granting of appellees' motion to quash appellants'  
13 subpoenas duces tecum is founded upon two alternative  
14 theories. First, appellees argue that the granting of the  
15 subpoenas would have violated the mandate of Rule 16(b) of  
16 the Federal Rules of Criminal Procedure, and second, that  
17 the subpoenas constituted a mere "fishing expedition"  
18 which would have produced no relevant evidence. (Appellees'  
19 Brief 38-40).

#### 20 A. Enforcement of Subpoenas Duces Tecum In An 21 Action Commenced Prior To Indictment Is Governed By The 22 Federal Rules of Civil Procedure.

23 Since all of the proceedings in the District  
24 Court in this matter occurred prior to the obtaining of an  
25 indictment, the Federal Rules of Criminal Procedure are  
26 wholly inapplicable. Rather, the Federal Rules of Civil



1 Procedure govern all aspects of the proceeding below,  
2 including enforcement of subpoenas. In Russo v. United  
3 States, 241 F.2d 285 (2d Cir. 1957), the Court stated:

4 "Having been filed before indictment,  
5 this proceeding [referring to a proceeding  
6 pursuant to Rule 41(e) of the Federal Rules  
7 of Criminal Procedure] is an independent  
8 civil proceeding and not merely preliminary  
9 to a criminal action." 241 F.2d at 287-88.

10 (Emphasis supplied.)

11 See also Lapides v. United States, supra; Weldon v. United  
12 States, supra. In Greene v. United States, 296 F.2d  
13 841 (2d Cir. 1961), vacated and remanded on other grounds,  
14 369 U.S. 403, the Court stated, in footnote 1, that:

15 "Presumably proceedings under Rule  
16 41(e) are governed by the Federal Rules  
17 of Civil Procedure where, as here, no  
18 prosecution has yet begun."

19 As set forth above, under the standards of DiBella there is  
20 no prosecution in esse to this date.

21 Consequently, Rule 16(b) of the Federal Rules  
22 of Criminal Procedure is wholly inapplicable.

23 B. The Subpoenas Comply With The Federal Rules  
24 Of Civil Procedure And Should Be Enforced.

25 The appropriate standard to be utilized in  
26 determining whether these subpoenas should be enforced is



1 Rule 45(b) of the Federal Rules of Civil Procedure. This  
2 rule permits the quashing or modification of the subpoenas  
3 only if they are "unreasonable and oppressive". That these  
4 subpoenas were not unreasonable nor oppressive, but rather  
5 were highly relevant and critical to appellants' case, was  
6 demonstrated in Appellants' Opening Brief, pages 14-21.  
7 Appellees' contention that the subpoenas constitute  
8 nothing more than a mere "fishing expedition" is negated by  
9 the limited and non-substantive matters sought. Nowhere  
10 do appellants seek to ascertain the extent of information  
11 in the hands of the government agents relating to any alleged  
12 inaccuracies of appellants' tax returns. The subpoenas  
13 request only non-substantive reports and other documents  
14 which would be highly instrumental in allowing appellants  
15 to demonstrate that the required admonition of constitutional  
16 rights was not given and that actual fraud and deceit  
17 was utilized by the agents in securing the books, records  
18 and other documents of appellants. In addition, it is  
19 believed that the material sought will impeach the testimony  
20 of the agents.

21 Since appellants admit that fraud and deception  
22 constitutes sufficient grounds for the suppression of all  
23 books, records and other documents obtained (appellees'  
24 brief, page 31), the subpoenas should be enforced regardless  
25 of this Court's decision as to any of the constitutional  
26 issues before it.



CONSTITUTIONAL RIGHTS ATTACH AT THE COMMENCEMENT  
OF A CRIMINAL TAX INVESTIGATION

Appellants devoted a major portion of their opening brief to an analysis of the application of certain constitutional rights to criminal tax investigations, with special emphasis upon the application of Supreme Court's recent decision of Miranda v. Arizona, 384 U.S. 436 (1966) and its underlying philosophy. Logically and rationally it cannot be seriously urged today that the constitutional guarantees of the Fourth, Fifth and Sixth Amendments do not attach at the commencement of a criminal tax investigation. If they do not so attach then taxpayers as a class will be denied rights now guaranteed to all others.

In support of the proposition that in the absence of fraud and deception a special agent is not required to admonish the taxpayer as to his constitutional rights under the Fifth and Sixth Amendments, appellees merely cite, without discussion, eight decisions of various courts, seven of which were decided prior to the Supreme Court's decision in Escobedo v. Illinois, 378 U.S. 478 (1964), and all of which were decided prior to the Supreme Court's decision in Miranda. A careful review of these authorities demonstrates not only their inapplicability to the facts of this case, but further that the bases of these cases, in light of Miranda, are now clearly erroneous.





1 In all of these eight cases, the only requirement  
2 which had to be satisfied prior to inculpatory statements  
3 being deemed admissible was whether such statements were  
4 voluntary. Miranda has completely obliterated this limited  
5 test and has set forth entirely new standards which, due  
6 to the widespread misconception of the distinction between  
7 a revenue agent and a special agent, must be applicable to  
8 tax investigations. A special agent is purely a criminal  
9 investigator, United States v. Silverstein, 314 F.2d 789,  
10 790 (1963); Russo v. United States, supra, and should be  
11 required to meet all of the standards imposed by Miranda on  
12 other criminal investigators.

13 IV

14 THE CORPORATE BOOKS AND RECORDS ARE PROTECTED  
15 BY THE FIFTH AMENDMENT'S PRIVILEGE AGAINST  
SELF-INCRIMINATION

16 A substantial portion of appellees' brief is  
17 devoted to the proposition that the corporate books and  
18 records and copies of such books and records are not within  
19 the scope of the Fifth Amendment and therefore, need not  
20 be returned or suppressed. In advancing this argument,  
21 appellees overlook the fact that appellants have con-  
22 sistently maintained that the books and records of appellants  
23 were obtained by the government agents through the employment  
24 of a massive scheme of fraud and deceit and that the Fourth  
25 Amendment, with its prohibition against unreasonable  
26 searches and seizures, has thus been violated. The



1 protection of the Fourth Amendment extends to corporations.  
2 Silverthorne Lumber Co. v. United States, 251 U.S. 385 (1920)

3 In attempting to argue against the applicability  
4 of the Fifth Amendment to corporate books and records,  
5 appellees have cited three cases. Wilson v. United States,  
6 221 U.S. 361 (1910); Wheeler v. United States, 226 U.S. 478  
7 (1912); and United States v. White, 322 U.S. 694 (1944).

8 These three cases, the most recent having been decided more  
9 than twenty-two years ago, do not reflect the trend of  
10 recent Supreme Court decisions which expand and define the  
11 protection of the Fifth Amendment. See, e.g., Miranda v.  
12 Arizona, supra; Murphy v. Water Front Commission, 378 U.S.  
13 52 (1964). Additionally, these cases cited by appellees  
14 involved the application of the Fifth Amendment to the  
15 books and records and other documents of large corporations  
16 or labor unions whose membership numbered in the thousands.

17 In the instant case, the appellant corporations  
18 had but one stockholder. Since, by liquidating these  
19 corporations Mr. Goodman could have operated his businesses  
20 as sole proprietorships, it seems paradoxical that he  
21 should be deemed to have lost his Fifth Amendment rights  
22 by choosing not to liquidate--a purely business decision.  
23 If choosing to operate in corporate form is deemed to  
24 deprive an individual of his Fifth Amendment privileges, it  
25 will constitute an unwarranted backward step from the  
26 philosophy of Miranda.



SUMMARY OF APPELLANTS' ARGUMENTS

Appellants' first argument is that the subpoenas duces tecum complied with Rule 45(b) of the Federal Rules of Civil Procedure and should have been enforced. Not only were the subpoenas reasonable in scope and not oppressive but the material sought by them was critical to the proving of appellants' case. Appellees' only arguments in support of the District Court's quashing of the subpoenas duces tecum were based upon the Federal Rules of Criminal Procedure which are wholly inapplicable.

Appellants' second argument was that appellants' books, records and other documents were obtained by a massive scheme of fraud and deceit perpetrated by the government agents. In addition to the usual confusion in taxpayers' minds about the nature of a tax investigation, this investigation originally commenced as a criminal investigation of a third party. The investigation subsequently altered its course so that it included appellants as subjects, and again was purely a criminal investigation from the outset. Within this framework, the agents purposefully and intentionally undertook a scheme of deception which capitalized upon appellants' confusion. They deliberately avoided making a meaningful explanation of their function (criminal investigators) or disclosing who was the subject of the investigation at any given time.





1 By explaining their function in a legalistic rather than  
2 in a meaningful fashion, they deliberately compounded  
3 appellants' confusion and uncertainty. They added to this  
4 confusion with the document receipts. If it is determined  
5 that the agents' conduct amounts to fraud or deceit, then  
6 all of the material obtained and copies thereof must be  
7 returned to appellants and its use must be suppressed in  
8 any future criminal proceedings.

9 Appellants' third argument was that the findings  
10 of fact and conclusions of law were clearly erroneous.  
11 The findings of fact are based entirely upon the unsupported  
12 oral testimony of the government agents, which testimony  
13 was significantly controverted by the testimony of  
14 Mr. Goodman, third party witnesses and appellees' own  
15 documents. Since the appellees had the burden to establish  
16 by clear and positive evidence that appellants' knowingly  
17 and intelligently waived their constitutional rights, the  
18 demonstrably false testimony of the government agents falls  
19 far short of satisfying this requirement. Accordingly, the  
20 findings of fact and conclusions of law are clearly  
21 erroneous and should be set aside.

22 Lastly, appellants argue that even if it is  
23 determined that the government agents were not guilty of  
24 fraud and deceit, all of the books and records obtained  
25 must nevertheless be suppressed as evidence in any future  
26 criminal proceeding and all copies thereof must be returned



1 to appellants. Taxpayers have the same rights as others  
2 with respect to constitutional immunities and privileges.  
3 If these rights are to be meaningful they must be available  
4 when they are most critically needed and not when the  
5 investigation has concluded. Under the appellees' approach,  
6 these rights do not become available until the investigation  
7 has been concluded and, in effect, the prosecution's case is  
8 perfected. If this position is approved by this Court  
9 then appellants' rights and the rights of all taxpayers  
10 become a very hollow thing indeed.

11 Even if considered in a light most favorable to  
12 appellees, there can be no doubt that the criminal  
13 investigation of Mr. Goodman commenced no later than  
14 December 18, 1964. It has been conceded that he was not  
15 warned or advised in any fashion of any of his constitution-  
16 al rights on this day. The entire philosophy of Miranda is  
17 that admonitions of constitutional rights must be conveyed  
18 in a fashion which is meaningful and understandable to  
19 laymen. The alleged statements made to Mr. Goodman on  
20 December 21, 1964 were ineffectual since he was unaware  
21 that the investigation was criminal in nature and, there-  
22 fore if any utterances were made, they were received  
23 completely out of perspective.

24 However, even if it should be determined that  
25 warnings were given on December 21, 1964 and that these  
26 warnings complied with the requirements of Miranda, they



1 could not rectify the wrong which occurred on December 18,  
2 1964 since, as was recently put in a very recent case,  
3 once Mr. Goodman "let the cat out of the bag," he  
4 suffered under the psychological and practical dis-  
5 advantages of having done so. He can "never get the cat  
6 back in the bag". See People v. Falk, \_\_\_ Cal. App. 2d  
7 \_\_\_ (D.C.A. 2d August 22, 1966).

8 Since all of appellants' books, records and  
9 other documents were given without an adequate understanding  
10 of the applicable constitutional rights, any waiver of  
11 such rights was unknowing and unintelligent. Accordingly,  
12 all such material and copies thereof must be returned and  
13 its use suppressed in any future proceedings.

#### 14 CONCLUSION

15 Appellants respectfully submit that the District  
16 Court erred in granting appellees motion to quash  
17 appellants' subpoenas duces tecum and that this case should  
18 be remanded to the District Court with instructions that  
19 the subpoenas be honored and further proceedings be held.

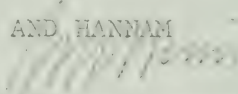
20 Appellants further submit that the Judgment of  
21 the District Court is erroneous and should be reversed  
22 and that this Court determine that all of appellants'  
23 books, records and memoranda were obtained in violation of  
24 the Fourth, Fifth and Sixth Amendments to the Constitution  
25 of the United States, that all such material be suppressed as  
26 evidence in all future proceedings, and that all such




1 material and all copies thereof be returned to appellants.

2 Respectfully submitted,


3 GOODSON AND HANNAM

4 By   
5 Walter S. Weiss

6 By   
7 Melvyn Mason

8 Counsel for Appellants

9  
10  
11  
12 I certify that, in connection with the preparation  
13 of this brief, I have examined Rules 18 and 19 of the  
14 United States Court of Appeals for the Ninth Circuit, and  
15 that, in my opinion, the foregoing brief is in full com-  
16 pliance with those rules.

17  
18   
19 / Walter S. Weiss





No. 20811

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**In the United States Court of Appeals  
for the Ninth Circuit**

---

**JACK GOODMAN, PARAMOUNT ICE CREAM CORP. AND  
FRIGID PROCESS CO., APPELLANTS**

*v.*

**UNITED STATES OF AMERICA, ET AL., APPELLEES**

---

**PETITION FOR REHEARING**

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FEB 14 1967



# In the United States Court of Appeals for the Ninth Circuit

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No. 20811

JACK GOODMAN, PARAMOUNT ICE CREAM CORP. AND  
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UNITED STATES OF AMERICA, ET AL., APPELLEES

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## PETITION FOR REHEARING

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Appellees, pursuant to Rule 23, respectfully petition for a rehearing of the decision in this case announced on November 18, 1966.

1. *The Court erred in holding that the order of the district court was appealable.* The test by which courts determine whether a proceeding is independent, and therefore appealable, is essentially practical and pragmatic. *Brown Shoe Co. v. United States*, 370 U.S. 294, 306 (1962); *DiBella v. United States*, 369 U.S. 121, 124, 129 (1962); *Carroll v. United States*, 354 U.S. 394, 404, note 17 (1957); *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949); *Cobbledick v. United States*, 309 U.S. 323, 324-325 (1940); *Cogen v. United States*, 278 U.S. 221, 225 (1929). In this case all original documents have been returned to appellant. He has no need for the

copies. His only purpose of seeking the "return" of the copies, which were made by the Internal Revenue Service and which he never possessed, is to insure the *suppression* of what is alleged to be illegally seized evidence. Where, as here, the only practical purpose to be served by the relief requested is *suppression* of the Government's evidence in some future criminal trial, the case lacks that severability from the criminal case which is essential for an independent, appealable order. *DiBella v. United States*, *supra*, 369 U.S. at 125-127; *Hill v. United States*, 346 F. 2d 175 (C.A. 9th), certiorari denied, 303 U.S. 956; *Austin v. United States*, 297 F. 2d 356 (C.A. 4th), vacated and dismissed, 353 F. 2d 512; *Badger Meter Mfg. Co. v. United States*, 216 F. Supp. 429 (E.D. Wis.), appeal dismissed, 63-1 USTC § 9332 (C.A. 7th), certiorari denied, 373 U.S. 902; *Greene v. United States*, 296 F. 2d 841 (C.A. 2d), vacated with instructions to dismiss appeal, 369 U.S. 403; *Grant v. United States*, 291 F. 2d 227 (C.A. 2d), vacated with instructions to dismiss appeal, 369 U.S. 401. As this Court pointed out in *Hill*, "appellant will have ample opportunity to move for this suppression at any criminal proceeding that may be brought against him." 346 F. 2d at 177. The fact that no criminal proceeding has as yet been instituted does not render such an order appealable. There were no criminal proceedings in *Hill*, *Austin*, or *Badger Meter*.

2. *The Court erred in holding that, where documents have been illegally seized, copies made by the*

*Government must be returned along with the originals.* We respectfully submit that the authorities cited for this proposition do not support it. There was no order for return of copies in *Silverthorne Lumber Co. v. United States*, 251 U.S. 385, 392. Judge Learned Hand did make such an order in *United States v. Krause*, 270 Fed. 578 (S.D.N.Y.), but we are unable to see that the authorities he cited support him. This Court's statement in *Boren v. Tucker*, 239 F. 2d 767, was plainly a dictum. *In re Sana Laboratories, Inc.*, 115 F. 2d 717 (C.A. 3d), and *United States v. Pack*, 146 F. Supp. 367 (D. Del.), seem to us rather to support the Government's right to retain copies under the circumstances of this case.

There are a number of reasons why the Government has a right to retain copies, even though the evidence is suppressed in any criminal proceeding against the owner of the illegally seized originals:

a. The Government has a right to use the evidence against a third party whose rights have not been violated by the illegal seizure. *Wong Sun v. United States*, 372 U.S. 474, 492; *United States v. Granello and Levine*, 243 F. Supp. 325, 326-328 (S.D.N.Y.), affirmed, 365 F. 2d 990, 995-996 (C.A. 2d), petition for certiorari pending.

b. The Government has a right to use the evidence against the owner, if he deliberately opens the door to such use at the trial. *Walder v. United States*, 347 U.S. 62, 65.

c. The right of the Government to use the evidence in a purely civil or administrative proceeding involving the owner is still an open question. *Plymouth Sedan v. Pennsylvania*, 380 U.S. 693, 700-702; *Cleary v. Bolger*, 371 U.S. 392, 403, 413 (concurring and dissenting opinions); *Zamaroni v. Philpott*, 346 F. 2d 365 (C.A. 7th), certiorari denied, 382 U.S. 903.

d. The copies, having been made by Internal Revenue officials, are the property of the United States and cannot be released without executive authority. *United States ex rel. Touhy v. Ragen*, 340 U.S. 462; 5 U.S.C. 22; Treasury Regulations 12, Article 80.

In view of the foregoing, it is respectfully submitted that a rehearing should be granted.

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#### CERTIFICATE OF COUNSEL

The undersigned counsel for the United States hereby certifies that the foregoing petition for rehearing is presented in good faith and not for the purpose of delay. It is further certified that service



of this petition has been made on opposing counsel by sending four copies thereof on this \_\_\_\_\_ day of December, 1966, in an envelope, with postage prepaid, properly addressed to them as follows:

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6380 Wilshire Boulevard  
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